



OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Audit Report

Audit of EPA's Fiscal 2006 and 2005 Consolidated Financial Statements

Report No. 2007-1-00019

November 15, 2006



Abbreviations

CFC	Cincinnati Finance Center
CNC	Currently Not Collectible
EPA	U.S. Environmental Protection Agency
FFMIA	Federal Financial Management Improvement Act
FMFIA	Federal Managers' Financial Integrity Act
FMO	Financial Management Office
IAG	Interagency Agreement
IFMS	Integrated Financial Management System
HHS	Health and Human Services
OCFO	Office of the Chief Financial Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget
RSSI	Required Supplementary Stewardship Information

Cover photo: Columbia River, near Multnomah Falls, Oregon (EPA OIG photo).



At a Glance

Catalyst for Improving the Environment

Why We Did This Audit

We performed this audit in accordance with the Government Management Reform Act, which requires 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 presented in all material respects.
- EPA's internal controls over financial reporting were in place.
- EPA management complied with applicable laws and regulations.

Background

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

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

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

www.epa.gov/oig/reports/2007/20061115-2007-1-00019.pdf

Audit of EPA's Fiscal 2006 and 2005 Consolidated Financial Statements

EPA Receives Unqualified Opinion

We rendered an unqualified, or clean, opinion on EPA's Consolidated Financial Statements for fiscal 2006 and 2005, meaning that they were fairly presented and free of material misstatement.

Internal Control Reportable Conditions Noted

We noted the two following reportable conditions:

- EPA implemented two accounting processes in fiscal 2006 that led to misstatements of the Agency's fiscal 2006 bad debt expense, revenue, contra revenue, advance accounts, and unearned revenue accounts. The processes included reclassifying receivables older than 2 years as currently not collectible, and transferring the receivables and related allowance accounts from regional financial management offices to financial management centers.
- EPA did not properly account for advance funding agreements with other Federal Government agencies. EPA recorded advances disbursed under Interagency Agreements as expenses instead of as assets. As a result, EPA overstated expenses and understated assets by \$55,982,983.

Noncompliance With Laws and Regulations Noted

EPA is in noncompliance with regulations relating to reconciling intragovernmental transactions. The Agency did not reconcile material activity and balances with the Department of Health and Human Services during the year, and had out of balance situations with many other agencies.

Agency Comments and Office of Inspector General Evaluation

In a memorandum received on November 13, 2006, from the Chief Financial Officer, the Agency agreed with the issues raised and indicated it will take needed corrective actions.



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

OFFICE OF
INSPECTOR GENERAL

November 15, 2006

MEMORANDUM

SUBJECT: Audit of EPA's Fiscal 2006 and 2005 Consolidated Financial Statements
Report No. 2007-1-00019

FROM: 
Paul C. Curtis
Director, Financial Statement Audits

TO: Lyons Gray
Chief Financial Officer

Attached is our audit report on the U.S. Environmental Protection Agency's fiscal 2006 and 2005 consolidated financial statements. We are reporting a reportable condition and noncompliance with laws and regulations related to EPA's accounting for interagency activity, as well as a reportable condition related to erroneous postings to bad debt expense. Attachment 3 contains the status of recommendations from prior years.

The estimated cost of this report – calculated by multiplying the project's staff days by the applicable daily full cost billing rates in effect at the time – is \$2,561,416.

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

In accordance with EPA Manual 2750, *Audit Management Process*, you are required to provide us with a written response to the final audit report within 90 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 or not to close this report in our audit tracking system.

Should you or your staff have any questions about the report, please contact me at (202) 566-2523, or Melissa Heist, Assistant Inspector General of Audit, at (202) 566-0899.

Attachments

cc: See Appendix III, Report Distribution List

Table of Contents

Inspector General's Report on EPA's Fiscal 2006 and 2005 Consolidated Financial Statements	1
Review of EPA's Required Supplementary Stewardship Information, Required Supplementary Information, Supplemental Information, and Management's Discussion and Analysis.....	2
Evaluation of Internal Controls	2
Tests of Compliance with Laws and Regulations.....	5
Prior Audit Coverage.....	6
Agency Comments and OIG Evaluation	7
Attachments	8
1. Reportable Conditions.....	8
EPA's Implementation of Accounting Processes Resulted in Misstatements	9
EPA Misclassified Interagency Agreement Advances to Other Federal Agencies	11
2. Compliance with Laws and Regulations	14
EPA Did Not Reconcile Differences With Trading Partners	15
3. Status of Prior Audit Report Recommendations	17
Appendices	19
I. EPA's Fiscal 2006 and 2005 Consolidated Financial Statements	19
II. Agency's Response to Draft Report.....	97
III. Report Distribution List.....	100

Inspector General's Report on EPA's Fiscal 2006 and 2005 Consolidated Financial Statements

The Administrator
U.S. Environmental Protection Agency

We have audited the consolidated balance sheets of the U.S. Environmental Protection Agency (EPA, or the Agency) as of September 30, 2006 and 2005, and the related consolidated statements of net cost, net cost by goal, changes in net position, financing and custodial liability, and the combined statement of budgetary resources for the years then ended. These financial statements are the responsibility of EPA's management. Our responsibility is to express an opinion on these financial statements based upon our audit.

We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial statements contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 06-03, *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.

As discussed in Note 1.J., the Agency changed its accounting for delinquent debts in fiscal 2006 to comply with OMB Circular A-129, Policies for Federal Credit Programs and Non-Tax Receivables.

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

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

In our opinion, the consolidated financial statements present fairly, including the accompanying notes, in all material respects, the consolidated assets, liabilities, net position, net cost, net cost by goal, changes in net position, reconciliation of net cost to budgetary obligations, custodial

activity, and combined budgetary resources of EPA, as of and for the years ended September 30, 2006 and 2005, in conformity with accounting principles generally accepted in the United States of America.

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

We inquired of EPA's management as to its methods for preparing Required Supplementary Stewardship Information (RSSI), Required Supplementary Information, Supplemental Information, and Management's Discussion and Analysis, and reviewed this information for consistency with the financial statements. The Supplemental Information includes the unaudited Superfund Trust Fund financial statements for fiscal 2006 and 2005, 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, 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 any other laws, regulations, and government-wide policies identified by OMB that could have a direct and material effect on the financial statements or RSSI.

In planning and performing our audit, we considered EPA's internal controls over financial reporting by obtaining an understanding of the Agency's internal controls, determining whether

internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 06-03, *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. 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 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. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We noted certain matters discussed below involving the internal control and its operation that we consider to be reportable conditions, although none of the reportable conditions is believed to be a material weakness.

In addition, we considered EPA's internal control over the RSSI by obtaining an understanding of the Agency's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin No. 06-03. 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 2006 Performance and Accountability Report*, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 06-03. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not express an opinion on such controls.

Reportable Conditions

Reportable conditions are internal control weaknesses coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation of internal controls that could adversely affect the organization's

ability to meet the OMB objectives for financial reporting discussed above. In evaluating the Agency's internal control structure, we identified two reportable conditions, as follows:

Implementing Accounting Processes Resulted in Misstatements

EPA implemented two accounting processes in fiscal 2006 that led to misstatements of the Agency's fiscal 2006 bad debt expense, revenue, contra revenue, advance accounts, and unearned revenue accounts. The Agency adopted OMB Circular A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*, which provides for the reclassification of receivables older than 2 years as currently not collectible (CNC). The Agency's revised CNC transaction posting model was not mapped to the allowance account and did not include an entry to offset the reduction of current year revenue. The combination of subsequent CNC reclassifications and allowance adjustment caused the misstatement of EPA's fiscal 2006 bad debt expense, revenue, contra revenue, and advance accounts. In addition, the Agency transferred the receivables and related allowance accounts from regional financial management offices to financial management centers. Inadvertent increases of allowance accounts and subsequent adjustments to remove the allowance accounts resulted in incorrect postings to bad debt expense, revenue, contra revenue, and unearned revenue accounts.

Misclassified Interagency Agreement Advances to Other Federal Agencies

EPA did not properly account for advance funding agreements with other Federal Government agencies. Though Federal accounting standards and EPA's accounting procedures require that advances made to other agencies be recorded as assets, EPA recorded advances disbursed under Interagency Agreements (IAGs) as an expense. This occurred because the other Federal agencies drew down the funds under the IAGs soon after the funds were obligated. EPA contributed to the problem by not following its own accounting policies or that of the U.S. Treasury. In addition, the Agency has not developed written procedures for recovering advances from other Agencies. As a result, EPA overstated expenses and understated assets by \$55,982,983.

We have reported less significant matters regarding internal controls in the form of position papers during the course of the audit. We will not issue a separate management letter.

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

OMB Bulletin No. 06-03, *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 reporting under FMFIA, material weaknesses are defined differently than they are for financial statement audit purposes. OMB Circular A-123, *Management Accountability and Control*, defines a material weakness as a deficiency that the Agency head determines to be significant enough to be reported outside the Agency.

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

The Agency did not report, and our audit did not detect, any material weaknesses for fiscal 2006.

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. 06-03, *Audit Requirements for Federal Financial Statements*. The OMB guidance also requires that we report on EPA's compliance with the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and did not test compliance with all laws and regulations applicable to EPA.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. A number of ongoing investigations involving EPA's grantees and contractors could disclose violations of laws and regulations, but a determination about these cases has not been made. In addition, the Agency is changing the confidential financial disclosure forms required to be filed by EPA employees, the forms are for the period October 1, 2005 thru December 31, 2006 and are due February 15, 2007. Since the Agency did not require these forms to be prepared in time to be reviewed for this audit, we did not perform any tests or inquiries about those reports. Had the Agency required the confidential financial disclosure forms be prepared and had we been able to review the reports and perform tests or make additional inquiries, matters may have come to our attention that would require reporting.

Our tests of laws and regulations disclosed the following noncompliance issue.

EPA Did Not Reconcile Differences With Trading Partners

EPA has taken some action to reconcile its intragovernmental activity on a quarterly basis, but did not reconcile differences for intragovernmental transactions with 47 of its trading partners. During the fourth quarter, these differences totaled \$518 million. EPA has experienced problems reconciling with its intragovernmental trading partners in prior years, including differences with the HHS that prohibited EPA from fully complying with the applicable U.S. Treasury requirements. In fiscal 2006, we found that HHS records receipts from EPA as deferred revenue

while EPA erroneously records disbursements to HHS as expenses when paid, rather than advances. Without confirmation from its trading partners, EPA has limited assurance that intragovernmental balances are accurate. Attachment 2 provides additional details, and our recommendation on actions that should be taken on this matter.

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 memorandum dated January 4, 2001, *Revised Implementation Guidance for the Federal Financial Management Improvement Act*, 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 FFMIA requirements.

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

Prior Audit Coverage

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

- Payroll Internal Controls.
- General Ledger Adjustments for Receivables Transferred to Cincinnati Finance Center (CFC).
- Contingency Plans for Financial Applications.
- Reconciling and reporting intragovernmental transactions, assets, and liabilities by Federal trading partner.
- Recording Marketable Securities.
- Correcting Rejected Transactions.
- Assessing automated application processing controls for IFMS.
- Security Screenings for Non-Federal Personnel.
- Change Control Procedures for IFMS.

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

Agency Comments and OIG Evaluation

In a memorandum dated November 13, 2006, the Office of the Chief Financial Officer (OCFO) responded to our draft report.

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

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



Paul C. Curtis
Director, Financial Statement Audits
Office of Inspector General
U.S. Environmental Protection Agency
November 14, 2006

Reportable Conditions

Table of Contents

1 - EPA's Implementation of Accounting Processes Resulted in Misstatements	9
2 - EPA Misclassified Interagency Agreement Advances to Other Federal Agencies	11

1 - EPA's Implementation of Accounting Processes Resulted in Misstatements

In fiscal 2006, EPA adopted OMB Circular A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*, which provides for the reclassification of receivables older than 2 years as currently not collectible (CNC). The general ledger automated posting model established by the Agency to record CNC entries reduced the receivables – related revenue or advance account – and recorded the CNC receivables in memo accounts. However, the posting model was not mapped to the allowance accounts and did not include an entry to offset the reduction of current year revenue. The allowance account was subsequently adjusted for decreases in the open accounts receivable due to CNC reclassifications. The combination of the CNC reclassifications and subsequent allowance adjustment caused the initial misstatement of EPA's fiscal 2006 bad debt expense, revenue, contra revenue, and advance accounts. In the fourth quarter, the Agency revised the accounting model to include the allowance account.

In addition, the Agency has been moving its financial operations from the regional FMOs to the finance management centers over the past several years. In fiscal 2006, the receivables and related allowance accounts were transferred from FMOs to financial management centers. Fourth quarter transfers included amounts previously classified by the FMOs as CNC under the original accounting model. By reducing the receivables recorded by the FMOs under the original accounting model, and recording the transfer under the revised accounting model, the allowance accounts were inadvertently increased. Subsequent adjustments to remove the allowance accounts resulted in additional incorrect postings to bad debt expense, revenue, contra revenue, and unearned revenue accounts.

As a result, at the end of fiscal 2006, bad debt expense has a credit balance of \$54,792,630 and several revenue accounts have debit balances totaling \$9,342,912. The US Standard General Ledger dictates that bad debt expense and contra revenue accounts should normally have a debit balance and revenue accounts should normally have a credit balance. In addition, the advance account for Superfund future cost special account receivables has a debit balance of \$2,749,860. The account for advances received from others should normally have a credit balance.

Recommendations

We recommend the OCFO require the Reporting and Analysis Staff:

1. Make the necessary corrections to properly adjust fiscal 2006 bad debt expense, revenue and advance accounts to their normal balances.
2. Work with finance offices to correct the impact of any future CNC reductions.

We recommend the OCFO have the Financial Management Offices and Finance Centers:

3. Monitor CNC decrease entries to transactions for abnormal increases in the allowance accounts and decreases in revenue.
4. Notify Reports and Analysis Staff of these CNC decrease entries and any allowance for doubtful account decrease entries needed to correct allowance accounts.

Agency Comments and OIG Evaluation

The Agency generally concurred with our recommendations; however, OCFO only made a partial adjustment to bad debt expense for financial statement purposes. Our analysis indicated that there were entries that created abnormal balances in certain revenue and liability accounts that need to be adjusted.

2 - EPA Misclassified Interagency Agreement Advances to Other Federal Agencies

EPA did not properly account for advance funding agreements with other Federal Government agencies. These agreements usually involve the joint funding of expenses, grants or contracts for projects that are administered by another Government agency. Federal accounting standards and EPA's accounting procedures require that advances made to other agencies be recorded as assets that are reduced when goods and services are received, contract terms are met, or progress is made. However, EPA recorded advances disbursed to administering agencies under IAGs as an expense. This occurred because the other Federal agencies drew down the funds under the IAGs soon after the funds were obligated. EPA contributed to the problem by not following its own accounting policies or that of the U.S. Treasury by not ensuring it received support for the funds disbursed under the IAGs. In addition, the Agency has not developed written procedures for recovering advances from other Agencies when they do not provide proper cost documentation on advance agreements. As a result, EPA overstated expenses and understated assets by \$55,982,983.

The Treasury Financial Manual Volume 1, Part 2, Chapter 2500, Section 2515.10, *Payments to Other Appropriations and Funds as Reimbursements or Advances*, states:

“Advance Payments Required by Law – These transactions are required by a specific law, by which a determined amount is to be transferred from one agency and merged with a specific account of another agency. The amount is payment in advance for goods and services that will be provided by the second agency.

Advance Payments to Certain Revolving and Working Capital Funds - These are transactions authorized by law, by which certain revolving and working capital funds are permitted to request payment for goods and services in advance of delivery. These advances represent a liability of the revolving or working capital fund pending delivery of the goods and services.

Advance Payments to Management Funds - Management fund accounts are authorized by specific laws to receive advances from appropriations to ease accounting for and administration of intra-governmental activities. These accounts are classified either as annual or no-year accounts, depending on the circumstances.

Advance Payments to Consolidated Working Funds - advances for goods and services to be provided within the same fiscal year by the performing agency through use of its own facilities may be made to "consolidated working fund" accounts of the performing agency under Section 601 of the Economy Act, 31 U.S.C. 686. This method of financing reimbursement for goods and services provided by one agency to another should be used only in instances where arrangements for current billings and reimbursements would be impractical.”

Statement of Federal Financial Accounting Standards No. 1, *Accounting for Selected Assets and Liabilities*, dated March 30, 1993, defines advances as cash outlays made by a Federal entity to its employees, contractors, grantees, or others to cover a part or all of the recipients' anticipated expenses. Statement of Federal Financial Accounting Standards No. 1 states that advances should be recorded as assets. The advances should be reduced when goods or services are received, contract terms are met, or progress is made.

A Disbursement Interagency Agreement is an agreement in which another Federal agency delivers goods or services to EPA, and EPA disburses funds to the other agency's account to pay for that agency's expenses. EPA Resource Management Directives 2550c, Paragraphs 6. a. and b. define the methods of payment for goods or services under disbursement IAGs.

- “a. Reimbursable Payment. The agency performing the work specified in the agreement periodically bills the other agency or agencies who are party to the agreement for amounts obligated or costs incurred in providing the services or goods. The agency is then reimbursed by the other agencies for those costs.*
- b. Advance Payment. Some agencies which perform work on a reimbursable basis must receive payment for the provision of goods or services in advance, i.e., before they actually incur costs. In this arrangement, the agency requesting the work provides advance payment to the other agency; these funds are placed in the other agency's working fund account. As work is performed, the agency doing the work will report its expenditures on a regular basis to the agency requesting the work. The requesting agency is then able to liquidate the advance payment in its accounting records.”*

During disbursement testing at CFC, we identified an advance funded IAG in our sample universe that was misclassified in IFMS. Based on the results of that testing, we expanded our review to look at all EPA advance IAGs with other Federal agencies. The review included data retrieved from the Integrated Grants Management System that identified EPA IAGs with other Federal agencies that were marked "advance" funded. From the search of the Integrated Grants Management System and discussions with EPA project officers and grant specialists, CFC verified which IAGs were truly advance funded. Then they tried to determine the status of those IAGs by obtaining progress reports with supporting cost detail. Where available, CFC used the most recent progress reports that included supporting cost detail from its files. CFC reviewed the detailed cost documentation to try to determine total advances, expenditures incurred to date, and the remaining outstanding advance for the advance funded IAGs. Based on this review CFC identified IAG advances totaling \$55,982,983 that were misclassified as operating expenses.

Payments made under disbursement IAGs are typically processed with transaction codes and types that record transactions as operating expenses. We found that CFC recorded the entire \$55,982,983 of advance payments to other Federal agencies as operating expenses rather than as advances. Further, CFC did not originally record the advance payments as an advance in fiscal 2006, and did not follow up on the status of the outstanding advance. As a result of CFC recording advances as expenses, expenses were overstated by \$55,982,983.

Recommendations

We recommend the OCFO have the CFC:

5. Ensure all future payments under advanced funded disbursement IAGs are recorded as advances, and expenses are recognized in the period incurred.

We recommend the OCFO:

6. Establish written procedures for recovering advances from other agencies when those agencies fail to provide proper and timely supporting documentation of the funds being used.

Agency Comments and OIG Evaluation

The CFO generally agreed with our recommendations, agreeing to coordinate efforts with the Office of Grants and Debarment to strengthen procedures when entering into agreements with other Federal entities so that both entities will be able to accurately compile financial reporting information. However, the OCFO stated they have written policies and procedures in place governing intragovernmental transactions, and will refine them after issuance of OMB business rules governing such transactions. OCFO volunteered to participate on the government-wide committee designed to resolve trading partner issues among agencies.

Compliance with Laws and Regulations

Table of Contents

3 - EPA Did Not Reconcile Differences With Trading Partners.....	15
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3 - EPA Did Not Reconcile Differences With Trading Partners

EPA has taken some action to reconcile its intragovernmental activity on a quarterly basis, but has not reconciled differences for intragovernmental transactions with 47 of its trading partners. During the fourth quarter, these differences totaled \$518 million. EPA has experienced problems reconciling with its intragovernmental trading partners in prior years, including being unable to reconcile differences with the HHS that prohibited EPA from fully complying with the applicable U.S. Treasury requirements. In fiscal 2006, we found that HHS records receipts from EPA as deferred revenue, while EPA erroneously records disbursements to HHS as expenses when paid, rather than advances. Without confirmation from its trading partners, EPA has limited assurance that intragovernmental balances are accurate.

Of the 47 trading partners with differences, we identified three with material differences, as shown below. Two of the three, DHS and HHS, had outstanding material differences for each quarter of fiscal 2006.

<u>Federal Agency</u>	<u>Difference</u>	<u>Category of Difference</u>
Department of Treasury General Fund	\$237 million	Not Assigned to Any Category
Department of Homeland Security	\$204 million	Unbilled Accounts Receivables/Revenue
Department of Health and Human Services	(\$96 million)	Advances from Other Agencies
Other Federal Agencies	\$173 million	Various Categories

The U.S. Treasury's *Federal Intragovernmental Transactions Accounting Policies Guide* (July 2005) provides Government-wide accounting policies for Federal agencies to account for and reconcile intragovernmental transactions. The Guide states that agencies should reconcile and confirm intragovernmental activity and balances with their trading partners before submitting year-end data and reporting it in audited financial statements. The Guide also provides tools (procedures and examples) to facilitate quarterly reconciliation of intragovernmental activities.

Intragovernmental transactions have been classified by the Government Accountability Office as a Government-wide internal control weakness due to the lack of standardization in recording and processing intragovernmental activities. To resolve the issue, OMB established standard business rules (Memorandum M-03-01, October 4, 2002) to be used in intragovernmental exchange activities. OMB Circular A-136, *Financial Reporting Requirements*, which was updated July 24, 2006, requires Federal agencies to report intragovernmental assets, liabilities, revenue, and certain reporting entities with their trading partners. This information is presented in the financial statements, the Closing Package, and should be in agreement with line items reported on the balance sheet. Intragovernmental balances and transactions are a key component in the consolidation of the financial information submitted by Federal entities and in the overall compilation process of the government-wide financial report.

Since fiscal year 2003 we have reported the need to reconcile differences with HHS as a noncompliance issue. The Agency has not acted to reconcile its intragovernmental activity on a quarterly basis with HHS, causing these differences to continue. EPA should increase its efforts to resolve these differences.

Recommendation

We recommend the OCFO:

7. Require the Office of Financial Management to reconcile the Agency's intragovernmental transactions to comply with Federal financial reporting requirements.

Agency Comments and OIG Evaluation

OCFO agreed with our recommendation.

Status of Prior Audit Report Recommendations

EPA's position is that "audit follow-up is an integral part of good management," and "corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations." The Chief Financial Officer is the Agency Follow-up Official and is responsible for ensuring that corrective actions are implemented. In fiscal 2006, OCFO included in its Organizational Assessment Measures a metric for audit follow-up. OCFO management regularly reviews these measures during OCFO's monthly Budget and Performance Review meetings.

The Agency has continued to make substantial progress in completing corrective actions from prior years. The status of issues from prior financial statement audits, that have corrective actions in process, are listed in the following table.

Audit Issue Areas with Corrective Actions in Process
<ul style="list-style-type: none"> <p>• Automated Application Processing Controls for IFMS: EPA has made progress towards replacing IFMS. However, until EPA implements the planned replacement automated accounting system that addresses past issues, we will continue to disclose a reportable condition concerning documentation of the current accounting system and its automated application processing controls.</p>
<ul style="list-style-type: none"> <p>• EPA Needs to Strengthen Practices Regarding Security Screening for Non-Federal Personnel: EPA had not completed the remaining actions in the Agency's fiscal 1999 Remediation Plan by the end of fiscal 2006. However, EPA reported that in October 2006 it published the Personal Identity Verification Handbook, which outlines procedures for conducting background investigations for non-Federal workers. We will schedule a review to evaluate the effectiveness of the Agency's implemented procedures.</p>
<ul style="list-style-type: none"> <p>• EPA Did Not Promptly Record Marketable Securities: The Agency plans to transfer the processing of marketable securities to the Cincinnati Finance Center (CFC) in January 2007. As part of the transfer, CFC will develop a reconciliation procedure to ensure a proper and complete non-cash asset balance.</p>
<ul style="list-style-type: none"> <p>• EPA Continues to Experience Difficulties in Reconciling Intragovernmental Transactions: The Agency has been working to reconcile Intragovernmental Transactions, however, as described in attachment 2, Compliance with Laws and Regulations, the Agency still has reconciling differences with many other Federal Government Agencies.</p>

Audit Issue Areas with Corrective Actions in Process

- **Weaknesses in Change Control Procedures for Integrated Financial Management System:**

EPA had not completed the remaining corrective action needed by the end of fiscal 2006. However, EPA reported that in October 2006 it finalized the ENDEVOR security plan that documents the system's implemented security controls. We will schedule a review to evaluate the effectiveness of the Agency's implemented procedures.

- **EPA Should Improve Payroll Internal Controls:**

EPA has made progress towards improving payroll internal controls to reduce default payments to current and separated employees. However, EPA has not implemented an automated control in PeoplePlus to limit the number of consecutive default payments. EPA plans to complete the remaining action by December 31, 2006.

- **EPA Needs to Improve Correction of Rejected Transactions:**

EPA had not completed the remaining action needed by the end of fiscal 2006. However, EPA published on November 1, 2006, formal procedures for managing rejected payroll transactions between PeoplePlus and IFMS. We will schedule a review to evaluate the effectiveness of the Agency's implemented procedures.

- **EPA Needs to Improve Contingency Plans for Financial Applications:**

Although EPA has made some progress in correcting this reportable condition, EPA still needs to (1) finalize contingency plans for all OCFO applications not subscribing to the National Computer Center Disaster Recovery Services Plan, and (2) update the personnel contact information within the NCC Critical Application Disaster Recovery Plan. OCFO plans to complete the first action by December 31, 2006. OCFO requested NCC update the Critical Application Disaster Recovery Plan.

**EPA's Fiscal 2006 and 2005
Financial Statements**

**SECTION IV
ANNUAL FINANCIAL
STATEMENTS**

Principal Financial Statements

Financial Statements

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

Notes to Financial Statements

- | | |
|----------|--|
| Note 1. | Summary of Significant Accounting Policies |
| Note 2. | Fund Balances with Treasury |
| Note 3. | Cash and Other Monetary Assets |
| Note 4. | Investments |
| Note 5. | Accounts Receivable |
| Note 6. | Other Assets |
| Note 7. | Loans Receivable, Net- Non-Federal |
| Note 8. | Accounts Payable and Accrued Liabilities |
| Note 9. | General Plant, Property and Equipment (PP& E) |
| Note 10. | Debt Due to Treasury |
| Note 11. | Stewardship PP&E |
| Note 12. | Custodial Liability |
| Note 13. | Other Liabilities |
| Note 14. | Leases |
| Note 15. | Pensions and Other Actuarial Liabilities |
| Note 16. | Cashout Advances, Superfund |
| Note 17. | Unexpended Appropriations – Other Funds |
| Note 18. | Amounts Held by Treasury |
| Note 19. | Commitments and Contingencies |
| Note 20. | Earmarked Funds |
| Note 21. | Exchange Revenues, Statement of Net Cost |
| Note 22. | Intragovernmental Costs and Exchange Revenue |
| Note 23. | Cost of Stewardship PP&E |
| Note 24. | Environmental Cleanup Costs |
| Note 25. | State Credits |
| Note 26. | Preauthorized Mixed Funding Agreements |
| Note 27. | Custodial Revenues and Accounts Receivable |
| Note 28. | Statement of Budgetary Resources |
| Note 29. | Recoveries and Resources Not Available, Statement of Budgetary Resources |
| Note 30. | Unobligated Balances Available |

Notes to Financial Statements (continued)

Note 31.	Undelivered Orders at The End of Period
Note 32.	Offsetting Receipts
Note 33.	Statement of Financing
Note 34.	Costs Not Assigned to Goals
Note 35.	Transfers-In and Out, Statement of Changes in Net Position
Note 36.	Imputed Financing Sources
Note 37.	Payroll and Benefits Payable
Note 38.	Other Adjustments, Statement of Changes in Net Position
Note 39.	Nonexchange Revenue, Statement of Changes in Net Position
Note 40.	Other, Statement of Financing

Required Supplementary Information (Unaudited)

1. Deferred Maintenance (Unaudited)
2. Supplemental Statement of Budgetary Resources (Unaudited)
3. Stewardship PP& E (Land)

Required Supplementary Stewardship Information (Unaudited)

Supplemental Information and Other Reporting Requirements (Unaudited)

1. Superfund Financial Statements and Related Notes
2. Improper Payments Information Act of 2002 (IPIA) Report

Environmental Protection Agency
Consolidated Balance Sheet
For the Periods Ending September 30, 2006 and 2005
(Dollars in Thousands)

	FY 2006	FY 2005
ASSETS		
Intragovernmental:		
Fund Balance With Treasury (Note 2)	\$ 11,173,443	\$ 12,139,207
Investments (Notes 4 and 18)	5,366,264	4,811,065
Accounts Receivable, Net (Note 5)	127,727	66,060
Other (Note 6)	59,143	2,335
Total Intragovernmental	\$ 16,726,577	\$ 17,018,667
Cash and Other Monetary Assets (Note 3)	10	10
Accounts Receivable, Net (Note 5)	243,824	374,668
Loans Receivable, Net - Non-Federal (Note 7)	30,836	39,347
Property, Plant & Equipment, Net (Note 9)	756,794	708,716
Other (Note 6)	4,278	2,789
Total Assets	\$ 17,762,319	\$ 18,144,197
Stewardship PP& E (Note 11)		
LIABILITIES		
Intragovernmental:		
Accounts Payable and Accrued Liabilities (Note 8)	107,525	119,836
Debt Due to Treasury (Note 10)	18,896	21,744
Custodial Liability (Note 12)	32,963	142,347
Other (Note 13)	102,934	106,530
Total Intragovernmental	\$ 262,318	\$ 390,457
Accounts Payable & Accrued Liabilities (Note 8)	\$ 725,667	\$ 730,278
Pensions & Other Actuarial Liabilities (Note 15)	39,408	39,380
Environmental Cleanup Costs (Note 24)	10,083	6,989
Cashout Advances, Superfund (Note 16)	223,760	270,811
Commitments & Contingencies (Notes 19 and 24)	8	1,950
Payroll & Benefits Payable (Note 37)	195,746	190,394
Other (Note 13)	131,322	98,064
Total Liabilities	\$ 1,588,312	\$ 1,728,323
NET POSITION		
Unexpended Appropriations - Other Funds (Note 17)	10,299,640	11,007,589
Cumulative Results of Operations - Earmarked Funds (Note 20)	4,177,329	-
Cumulative Results of Operation - Other Funds	1,697,038	5,408,285
Total Net Position	16,174,007	16,415,874
Total Liabilities and Net Position	\$ 17,762,319	\$ 18,144,197

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, 2006 and 2005
(Dollars in Thousands)**

	FY 2006	FY 2005
COSTS		
Gross Costs (Note 22)	\$ 9,215,502	\$ 8,497,422
Less:		
Earned Revenue (Notes 21, 22)	869,762	463,477
NET COST OF OPERATIONS (Note 22)	\$ 8,345,740	\$ 8,033,945

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, 2006
(Dollars in Thousands)**

	<u>Clean Air</u>	<u>Clean & Safe Water</u>	<u>Land Preservation & Restoration</u>	<u>Healthy Communities & Ecosystems</u>	<u>Compliance & Environmental Stewardship</u>
Costs:					
Intragovernmental	\$ 192,774	\$ 137,874	\$ 448,101	\$ 271,667	\$ 183,628
With the Public	764,539	3,717,427	1,870,476	1,030,019	598,997
Total Costs (Note 22)	<u>957,313</u>	<u>3,855,301</u>	<u>2,318,577</u>	<u>1,301,686</u>	<u>782,625</u>
Less:					
Earned Revenue, Federal	37,264	9,088	440,068	37,670	9,998
Earned Revenue, non Federal	2,228	2,822	297,395	31,080	2,149
Total Earned Revenue Note 22)	<u>39,492</u>	<u>11,910</u>	<u>737,463</u>	<u>68,750</u>	<u>12,147</u>
NET COST OF OPERATIONS (Note 22)	<u>\$ 917,821</u>	<u>\$ 3,843,391</u>	<u>\$ 1,581,114</u>	<u>\$ 1,232,936</u>	<u>\$ 770,478</u>

	<u>Not Assigned to Goals</u>	<u>Consolidated Totals</u>
Costs:		
Intragovernmental	\$ -	\$ 1,234,044
With the Public	-	7,981,458
Total Costs (Note 22)	<u>-</u>	<u>9,215,502</u>
Less:		
Earned Revenue, Federal	-	534,088
Earned Revenue, non Federal	-	335,674
Total Earned Revenue Note 22)	<u>-</u>	<u>869,762</u>
NET COST OF OPERATIONS (Note 22)	<u>\$ -</u>	<u>\$ 8,345,740</u>

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, 2005
(Dollars in Thousands)**

	<u>Clean Air</u>	<u>Clean & Safe Water</u>	<u>Land Preservation & Restoration</u>	<u>Healthy Communities & Ecosystems</u>	<u>Compliance & Environmental Stewardship</u>
Costs:					
Intragovernmental	\$ 186,667	\$ 209,631	\$ 376,717	\$ 280,492	\$ 174,321
With the Public	<u>803,822</u>	<u>3,297,570</u>	<u>1,639,157</u>	<u>992,360</u>	<u>539,857</u>
Total Costs (Note 22)	<u>990,489</u>	<u>3,507,201</u>	<u>2,015,874</u>	<u>1,272,852</u>	<u>714,178</u>
Less:					
Earned Revenue, Federal	20,295	15,444	42,567	15,638	12,000
Earned Revenue, non Fed	<u>2,205</u>	<u>2,570</u>	<u>312,487</u>	<u>32,509</u>	<u>1,353</u>
Total Earned Revenue (Note 22)	<u>22,500</u>	<u>18,014</u>	<u>355,054</u>	<u>48,147</u>	<u>13,353</u>
NET COST OF OPERATIONS (Note 22)	<u>\$ 967,989</u>	<u>\$ 3,489,187</u>	<u>\$ 1,660,820</u>	<u>\$ 1,224,705</u>	<u>\$ 700,825</u>
	<u>Not Assigned to Goals</u>	<u>Consolidated Totals</u>			
Costs:					
Intragovernmental	\$ 10,567	\$ 1,238,395			
With the Public	<u>(13,739)</u>	<u>7,259,027</u>			
Total Costs (Note 22)	<u>\$ (3,172)</u>	<u>\$ 8,497,422</u>			
Less:					
Earned Revenue, Federal	(291)	105,653			
Earned Revenue, non Fed	<u>6,700</u>	<u>357,824</u>			
Total Earned Revenue (Note 22)	<u>\$ 6,409</u>	<u>\$ 463,477</u>			
NET COST OF OPERATIONS (Note 22)	<u>\$ (9,581)</u>	<u>\$ 8,033,945</u>			

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, 2006 and 2005
(Dollars in Thousands)

	FY2006	FY2006	FY 2006	FY 2006	FY 2005
	<u>Consolidated Earmarked Funds</u>	<u>Consolidated All Other Funds</u>	<u>Eliminations</u>	<u>Consolidated Total</u>	<u>Consolidated Total</u>
Cumulative Results of Operations:					
Net Position - Beginning of Period	\$ 4,882,528	\$ 525,757	\$ -	\$ 5,408,285	\$ 5,186,611
Beginning Balances, as Adjusted	4,882,528	525,757	-	5,408,285	5,186,611
Budgetary Financing Sources:					
Appropriations Used	-	8,204,577	-	8,204,577	7,787,245
Nonexchange Revenue (Note 39)	456,025	-	-	456,025	318,662
Transfers In/Out (Note 35)	(32,672)	(127)	43,493	10,694	11,136
Trust Fund Appropriations	1,204,826	-	(1,204,826)	-	-
Total Budgetary Financing Sources	\$ 1,628,179	\$ 8,204,450	\$ (1,161,333)	\$ 8,671,296	\$ 8,117,043
Other Financing Sources (Non-Exchange)					
Transfers In/Out (Note 35)	-	(28)	-	(28)	436
Imputed Financing Sources (Note 36)	19,106	121,448	-	140,554	138,140
Total Other Financing Sources	\$ 19,106	\$ 121,420	\$ -	\$ 140,526	\$ 138,576
Net Cost of Operations	(1,219,124)	(7,154,589)	27,973	(8,345,740)	(8,033,945)
Net Change	428,161	1,171,281	(1,133,360)	466,082	221,674
	-	-	-	-	-
Cumulative Results of Operations	<u>\$ 5,310,689</u>	<u>\$ 1,697,038</u>	<u>\$ (1,133,360)</u>	<u>\$ 5,874,367</u>	<u>\$ 5,408,285</u>

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, 2006 and 2005
(Dollars in Thousands)**

	FY2006	FY2006	FY 2006	FY 2006	FY 2005
	<u>Consolidated Earmarked Funds</u>	<u>Consolidated All Other Funds</u>	<u>Eliminations</u>	<u>Consolidated Total</u>	<u>Consolidated Total</u>
Unexpended Appropriations:					
Net Position - Beginning of Period	\$ -	\$ 11,007,589	\$ -	\$ 11,007,589	\$ 10,860,136
Beginning Balances, as Adjusted	-	11,007,589	-	11,007,589	10,860,136
Budgetary Financing Sources:					
Appropriations Received	-	7,691,493	-	7,691,493	8,005,446
Appropriations Transferred In/Out (Note 35)	-	753	-	753	4,702
Other Adjustments (Note 38)	-	(195,618)	-	(195,618)	(75,450)
Appropriations Used	-	(8,204,577)	-	(8,204,577)	(7,787,245)
Total Budgetary Financing Sources	\$ -	\$ (707,949)	\$ -	\$ (707,949)	\$ 147,453
Total Unexpended Appropriations	-	10,299,640	-	10,299,640	11,007,589
TOTAL NET POSITION	<u>\$ 5,310,689</u>	<u>\$ 11,996,678</u>	<u>\$ (1,133,360)</u>	<u>\$ 16,174,007</u>	<u>\$ 16,415,874</u>

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, 2006 and 2005
(Dollars in Thousands)

	FY 2006	FY 2005
BUDGETARY RESOURCES		
Unobligated Balance, Brought Forward, October 1:	\$ 3,106,756	\$ 2,996,708
Recoveries of Prior Year Unpaid Obligations (Note 29)	264,710	174,641
Budgetary Authority:		
Appropriation	7,828,401	8,032,620
Borrowing Authority	-	436
Spending Authority from Offsetting Collections		
Earned:		
Collected	930,417	557,692
Change in Receivables from Federal Sources	87,322	5,311
Change in Unfilled Customer Orders:		
Advance Received	(8,617)	37,615
Without Advance from Federal Sources	149,607	118,144
Expenditure Transfers from Trusts Funds	43,366	48,682
Total Spending Authority from Offsetting Collections	1,202,095	767,444
Nonexpenditure Transfers, Net, Anticipated and Actual (Note 35)	1,258,208	1,348,725
Temporarily Not Available Pursuant to Public Law (Note 29)	(9,466)	(11,141)
Permanently Not Available (Note 29)	(198,484)	(78,244)
Total Budgetary Resources (Note 28)	\$ 13,452,220	\$ 13,231,189
 STATUS OF BUDGETARY RESOURCES		
Obligations Incurred:		
Direct	\$ 9,292,415	\$ 9,573,696
Reimbursable	912,718	550,737
Total Obligations Incurred (Note 28)	10,205,133	10,124,433
Unobligated Balances:		
Apportioned (Note 30)	3,156,100	3,018,689
Total Unobligated Balances	3,156,100	3,018,689
Unobligated Balances Not Available (Note 30)	90,987	88,067
Total Status of Budgetary Resources	\$ 13,452,220	\$ 13,231,189

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, 2006 and 2005
(Dollars in Thousands)

	FY 2006	FY 2005
CHANGE IN OBLIGATED BALANCE		
Obligated Balance, Net:		
Unpaid Obligations, Brought Forward, October 1	\$ 11,623,098	\$ 11,592,197
Less: Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(486,985)	(384,421)
Total Unpaid Obligated Balance, Net	11,136,113	11,207,776
Obligations Incurred, Net (Note 28)	10,205,133	10,124,433
Less: Gross Outlays (Note 28)	(10,607,195)	(9,918,889)
Less: Recoveries of Prior Year Unpaid Obligations, Actual (Note 29)	(264,710)	(174,641)
Change in Uncollected Customer Payments from Federal Sources	(225,252)	(102,566)
Total, Change in Obligated Balance	10,244,089	11,136,113
 Obligated Balance, Net, End of Period:		
Unpaid Obligations	10,956,328	11,623,098
Less: Uncollected Customer Payments from Federal Sources	(712,239)	(486,985)
Total, Unpaid Obligated Balance, Net, End of Period	\$ 10,244,089	\$ 11,136,113
 NET OUTLAYS		
Net Outlays:		
Gross Outlays (Note 28)	\$ 10,607,195	\$ 9,918,889
Less: Offsetting Collections (Note 28)	(976,843)	(664,878)
Less: Distributed Offsetting Receipts (Note 32)	(1,314,780)	(1,334,508)
Total, Net Outlays	\$ 8,315,572	\$ 7,919,503

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

**Environmental Protection Agency
Consolidated Statement of Financing
For the Periods Ending September 30, 2006 and 2005
(Dollars in Thousands)**

	FY 2006	FY 2005
RESOURCES USED TO FINANCE ACTIVITIES:		
Budgetary Resources Obligated		
Obligations Incurred	\$ 10,205,133	\$ 10,124,433
Less: Spending Authority from Offsetting Collections and Recoveries	(1,466,805)	(942,084)
Obligations, Net of Offsetting Collections	\$ 8,738,328	\$ 9,182,349
Less: Offsetting Receipts (Note 32)	(1,314,780)	(1,334,508)
Net Obligations	\$ 7,423,548	\$ 7,847,841
Other Resources		
Imputed Financing Sources (Note 36)	140,554	138,140
Net Other Resources Used to Finance Activities	\$ 140,554	\$ 138,140
 Total Resources Used To Finance Activities	 \$ 7,564,102	 \$ 7,985,981
RESOURCES USED TO FINANCE ITEMS		
NOT PART OF THE NET COST OF OPERATIONS:		
Change in Budgetary Resources Obligated	\$ 722,153	\$ (33,501)
Resources that Fund Prior Periods Expenses (Note 33)	(2,020)	(1,120)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations:		
Credit Program Collections Increasing Loan Liabilities for Guarantees or Subsidy Allowances	4,114	4,337
Offsetting Receipts Not Affecting Net Cost	109,955	87,031
Resources that Finance Asset Acquisition	(115,641)	(137,277)
 Total Resources Used to Finance Items Not Part of the Net Cost of Operations	 \$ 718,561	 \$ (80,530)
 Total Resources Used to Finance the Net Cost of Operations	 \$ 8,282,663	 \$ 7,905,451

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

**Environmental Protection Agency
Consolidated Statement of Financing
For the Periods Ending September 30, 2006 and 2005
(Dollars in Thousands)**

	FY 2006	FY 2005
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 (Note 33)	\$ 4,776	\$ 3,889
Increase in Environmental and Disposal Liability (Note 33)	3,352	99
Increase in Unfunded Contingencies (Note 33)	-	1,525
Upward/Downward Reestimates of Credit Subsidy Expense (Note 33)	-	3
Increase in Public Exchange Revenue Receivables	(35,668)	(101,645)
Increase in Workers Compensation Costs (Note 33)	37	-
Other (Note 40)	1,823	1,969
Total Components of Net Cost of Operations that Require or Generate Resources in Future Periods	\$ (25,680)	\$ (94,160)
Components Not Requiring/Generating Resources:		
Depreciation and Amortization	\$ 56,959	\$ 39,760
Expenses Not Requiring Budgetary Resources	31,798	182,894
Total Components of Net Cost that Will Not Require or Generate Resources	\$ 88,757	\$ 222,654
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	\$ 63,077	\$ 128,494
Net Cost of Operations	\$ 8,345,740	\$ 8,033,945

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

**Environmental Protection Agency
Statement of Custodial Activity
For the Periods Ending September 30, 2006 and 2005
(Dollars in Thousands)**

	<u>FY 2006</u>	<u>FY 2005</u>
Revenue Activity:		
Sources of Cash Collections:		
Fines and Penalties	\$ 35,842	\$ 141,087
Other	66,348	(53,836)
Total Cash Collections	<u>\$ 102,190</u>	<u>\$ 87,251</u>
Accrual Adjustment	(82,620)	63,565
Total Custodial Revenue (Note 27)	<u>\$ 19,570</u>	<u>\$ 150,816</u>
Disposition of Collections:		
Transferred to Others (General Fund)	\$ 102,298	\$ 87,334
Increases/Decreases in Amounts to be Transferred	(82,728)	63,482
Total Disposition of Collections	<u>\$ 19,570</u>	<u>\$ 150,816</u>
Net Custodial Revenue Activity (Note 27)	<u>\$ -</u>	<u>\$ -</u>

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

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

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

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

B. Reporting Entities

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

For FY 2006, the accompanying financial statements are grouped and presented in a consolidated manner. The accompanying financial statements include the accounts of all funds described in this note by their respective Treasury fund group.

General Fund Appropriations (Treasury Fund Groups 0000 – 3999)

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

b. Science and Technology (S&T) Appropriation: The S&T appropriation, Treasury fund group 0107, finances salaries, travel, science, technology, research and development activities including laboratory and center supplies, certain operating expenses, grants, contracts, intragovernmental agreements, and purchases of scientific equipment. These activities provide the scientific basis for the Agency's regulatory actions. In FY 2006,

Superfund research costs were appropriated in Superfund and transferred to S&T to allow for proper accounting of the costs. Environmental scientific and technological activities and programs include Clean Air; Clean and Safe Water; Americans Right to Know About Their Environment; Better Waste Management; Preventing Pollution and Reducing Risk in Communities, Homes, Workplaces, and Ecosystems; and Safe Food.

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

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

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

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

g. *Payments to Leaking Underground Storage Tank Appropriation:* The Payment to the Leaking Underground Storage Tank appropriation Treasury fund group 0251, authorizes appropriations from the General Fund of the Treasury to finance activities conducted through the Leaking Underground Storage Tank program.

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

The Asbestos Loan Program was authorized by the Asbestos School Hazard Abatement Act of 1986 to finance control of asbestos building materials in schools. Funds have not been appropriated for this Program since FY 1993. For FY 1993 and FY 1992, the program was funded by a subsidy appropriated from the General Fund for the actual cost of financing the loans, and by borrowing from Treasury for the unsubsidized portion of the loan. The Program Fund disburses the subsidy to the Financing Fund for increases in the subsidy. The Financing Fund receives the subsidy payment, borrows from Treasury and collects the asbestos loans.

i. Allocations and Appropriations transferred to the Agency: Allocations and appropriations transferred to the Agency from other federal agencies include funds from the Appalachian Regional Commission, which provides economic assistance to state and local developmental activities, and the Agency for International Development, which provides assistance on environmental matters at international levels. The transfer allocations are accounted for under Treasury fund group 0200 and the appropriation transfers are accounted for under 0108.

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

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

Revolving Funds (Treasury Fund Group 4000 – 4999)

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

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

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

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

Special Funds (Treasury Fund Group 5000 - 5999)

a. Environmental Services Receipt Account: The Environmental Services Receipt Account authorized by a 1990 Act, "To amend the Clean Air Act (P.L. 101-549)," Treasury fund group 5295, was established for the deposit of fee receipts associated with environmental programs, including radon measurement proficiency ratings and training, motor vehicle engine certifications, and water pollution permits. Receipts in this special fund will be appropriated to the S&T and the EPM appropriations to meet the expenses of the programs that generate the receipts.

b. Exxon Valdez Settlement Fund: The Exxon Valdez Settlement Fund authorized by a 1992 Act, "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 (P.L. 102-389)," Treasury fund group 5297, has funds available to carry out authorized environmental restoration activities. Funding is derived from the collection of reimbursements under the Exxon Valdez settlement as a result of an oil spill.

c. Pesticide Registration Fund: The Pesticide Registration Fund authorized by a 2004 act, "Consolidated Appropriations Act (P.L. 108-199)," Treasury fund group 5374, was authorized in 2004 for the expedited processing of certain registration petitions and associated establishment of tolerances for pesticides to be used in or on food and animal feed. Fees covering these activities, as authorized under the FIFRA Act of 1988, are to be paid by industry and deposited into this fund group.

Deposit funds (Treasury Fund Group 6000 – 6999)

Deposit funds include: Fees for Ocean Dumping; Nonconformance Penalties; Clean Air Allowance Auction and Sale; Advances without Orders; and Suspense and Payroll Deposits for Savings Bonds, and State and City Income Taxes Withheld. These funds are accounted for under Treasury fund groups 6050, 6264, 6265, 6266, 6275 and 6500.

Trust Funds (Treasury Fund Group 8000 – 8999)

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

b. Leaking Underground Storage Tank (LUST) Trust Fund: The LUST Trust Fund, Treasury fund group 8153, was authorized by the Superfund Amendments and Reauthorization Act of 1986 (SARA) as amended by the Omnibus Budget Reconciliation Act of 1990. The LUST appropriation provides funding to respond to releases from leaking underground petroleum tanks. The Agency oversees cleanup and enforcement programs which are implemented by the states. Funds are allocated to the states through cooperative agreements to clean up those sites posing the greatest threat to human health and the environment. Funds are used for grants to non-state entities including Indian Tribes under Section 8001 of the Resource Conservation and Recovery Act. The program is financed by a one cent a gallon tax on motor fuels which will expire in 2011.

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

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

C. Budgets and Budgetary Accounting

General Funds

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

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

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

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

Revolving Funds

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

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

Special Funds

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

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

Deposit Funds

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

Trust Funds

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

D. Basis of Accounting

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

E. Revenues and Other Financing Sources.

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

The Superfund program receives most of its funding through appropriations that may be used, within specific statutory limits, for operating and capital expenditures (primarily equipment). Additional financing for the Superfund program is obtained through: reimbursements from other federal agencies, state cost share payments under Superfund State Contracts (SSCs), and settlement proceeds from Potentially Responsible Parties (PRPs), under CERCLA Section 122(b)(3), placed in special accounts. The Agency establishes a special account when, at the time of the settlement agreement, there is potential "future work" at the site. Future work occurs when CERCLA response actions remain to be performed or costs remain to be incurred at the site. If no future work remains, funds should be deposited into the Trust Fund and made available for future appropriation.

The majority of all other funds receive funding needed to support programs through appropriations, which may be used, within statutory limits, for operating and capital expenditures. However, under Credit Reform provisions, the Asbestos Loan Program received funding to support the subsidy cost of loans through appropriations which may be used with statutory limits. The Asbestos Direct Loan Financing fund, an off-budget fund, receives additional funding to support the outstanding loans through collections from the Program fund for the subsidized portion of the loan. The last year Congress provided appropriations to make new loans was 1993.

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

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

F. Funds with the Treasury

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

G. Investments in U.S. Government Securities

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

H. Notes Receivable

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

I. Marketable Securities

The Agency records marketable securities at cost as of the date of receipt. Marketable securities are held by Treasury and reported at their cost value in the financial statements until sold (see Note 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. However, cost recovery expenditures are expensed when incurred since there is no assurance that these funds will be recovered (see Note 5).

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

The Agency also records accounts receivable from states for a percentage of Superfund site remedial action costs incurred by the Agency within those states. As agreed to under SSCs, cost sharing arrangements may vary according to whether a site was privately or publicly operated at the time of hazardous substance disposal and whether the Agency response action was removal or remedial. SSC agreements are usually for 10 percent or 50 percent of site remedial action costs. States may pay the full amount of their share in advance, or incrementally throughout the remedial action process. Allowances for uncollectible state cost share receivables have not been recorded, because the Agency has not had collection problems with these agreements.

Change in Accounting Principle for Delinquent Debt

In FY 2006, based on Treasury's guidance, "Managing Federal Receivables," Chapter 7, "Termination of Collection Action, Write-off and Close-out/Cancellation of Indebtedness," (issued May 2005), EPA implemented OMB Circular A-129, "Policies for Federal Credit Programs and Non-Tax Receivables." This Circular prescribes policies and procedures for justifying, designing, and managing Federal credit programs and for collecting non-tax receivables. OMB Circular A-129 requires write-off of delinquent debt older than two years. In the event debts meeting this criteria are not written off, documentation and justification must be provided to OMB in consultation with Treasury. Once written-off, the agency must either classify the debt as currently not collectible (CNC) or close-out the debt.

During FY 2006, the agency wrote-off and reclassified to CNC \$704.2 million of non federal receivables older than two years. Of this amount, approximately \$653.6 million are Superfund related receivables. This is a significant accounting change from FY 2005 when such amounts were reported as receivables and included in the allowance for doubtful accounts. The net book value of the receivables written-off and reclassified to CNC was \$20 million.

EPA, through its own actions or in coordination with the Departments of Treasury and Justice, continues to pursue collection of the CNC debts. When it is determined that no additional collection efforts will be made, the debt will be removed from CNC and closed-out.

K. Advances and Prepayments

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

L. Loans Receivable

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

M. Appropriated Amounts Held by Treasury

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

N. Property, Plant, and Equipment

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

A purchase of EPA-held or contractor-held personal property is capitalized if it is valued at \$25 thousand or more and has an estimated useful life of at least 2 years. Prior to implementing FAS, depreciation was taken on a modified straight-line basis over a period

of 6 years depreciating 10 percent the first and sixth year, and 20 percent in years 2 through 5. This modified straight-line method is still used for contractor-held property; detailed records are maintained and accounted for in contractor systems, not in FAS. All EPA-held personal property purchased before the implementation of FAS was assumed to have an estimated useful life of 5 years. New acquisitions of EPA-held personal property are depreciated using the straight-line method over the specific asset's useful life, ranging from 2 to 15 years.

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

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

Software for Working Capital Fund, a revenue generating activity, is capitalized if the purchase price was \$100 thousand or more with an estimated useful life of 2 years or more. All other funds capitalize software whose acquisition value is \$500 thousand or more in accordance with the provisions of SFFAS No. 10, "Accounting for Internal Use Software." Software is depreciated using the straight-line method over the specific asset's useful life ranging from 2 to 10 years.

O. Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by the Agency as the result of a transaction or event that has already occurred. However, no liability can be paid by the Agency without an appropriation or other collections.

Liabilities for which an appropriation has not been enacted are classified as unfunded liabilities and there is no certainty that the appropriations will be enacted. Liabilities of the Agency arising from other than contracts can be abrogated by the Government acting in its sovereign capacity.

P. Borrowing Payable to the Treasury

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

Q. Interest Payable to Treasury

The Asbestos Loan Program makes periodic interest payments to Treasury based on its debt to Treasury. At the end of FY 2006 and FY 2005, there was no outstanding interest payable to Treasury since payment was made through September 30.

R. Accrued Unfunded Annual Leave

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

S. Retirement Plan

There are two primary retirement systems for federal employees. Employees hired prior to January 1, 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 Civil Service Retirement and Federal Employees Retirement Systems, the Federal Employees Health Benefits Program, and the Federal Employees Group Life Insurance Program, provide federal agencies with the actuarial cost factors to compute the liability for each program.

T. Prior Period Adjustments

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

Note 2. Fund Balance with Treasury (FBWT)

Fund Balances with Treasury as of September 30, 2006 and 2005, consist of the following:

	<u>FY 2006</u>			<u>FY 2005</u>		
	<u>Entity Assets</u>	<u>Non-Entity Assets</u>	<u>Total</u>	<u>Entity Assets</u>	<u>Non-Entity Assets</u>	<u>Total</u>
Trust Funds:						
Superfund	\$ 35,086	\$ -	\$ 35,086	\$ 213,797	\$ -	\$ 213,797
LUST	25,497	-	25,497	17,613	-	17,613
Oil Spill & Misc.	6,789	-	6,789	9,169	-	9,169
Revolving Funds:						
FIFRA/Tolerance	8,074	-	8,074	7,970	-	7,970
Working Capital	77,635	-	77,635	69,401	-	69,401
Cr. Reform Finan.	400	-	400	489	-	489
Appropriated	10,820,079	-	10,820,079	11,655,287	-	11,655,287
Other Fund Types	182,303	17,580	199,883	157,303	8,178	165,481
Total	<u>\$ 11,155,863</u>	<u>\$ 17,580</u>	<u>\$ 11,173,443</u>	<u>\$ 12,131,029</u>	<u>\$ 8,178</u>	<u>\$ 12,139,207</u>

Entity fund balances, except for special fund receipt accounts, are available to pay current liabilities and to finance authorized purchase commitments (see Status of Fund Balances below). Entity Assets for Other Fund Types consist of special purpose funds and special fund receipt accounts, such as the Pesticide Registration funds and the Environmental Services receipt account. The Non-Entity Assets for Other Fund Types consist of clearing

accounts and deposit funds, which are either awaiting documentation for the determination of proper disposition or being held by EPA for other entities.

Status of Fund Balances:	<u>FY 2006</u>	<u>FY 2005</u>
Unobligated Amounts in Fund Balances:		
Available for Obligation	\$ 3,156,100	\$ 3,018,690
Unavailable for Obligation	90,987	88,066
Net Receivables from Invested Balances	(2,515,007)	(2,278,343)
Balances in Treasury Trust Fund (Note 18)	12,505	19,965
Obligated Balance not yet Disbursed	10,244,089	11,136,112
Non-Budgetary FBWT	<u>184,769</u>	<u>154,717</u>
Totals	\$ <u>11,173,443</u>	\$ <u>12,139,207</u>

The funds available for obligation may be apportioned by the OMB for new obligations at the beginning of the following fiscal year. Funds unavailable for obligation are mostly balances in expired funds, which are available only for adjustments of existing obligations. For FY 2006 and FY 2005 no differences existed between Treasury's accounts and EPA's statements for fund balances with Treasury.

Note 3. Cash and Other Monetary Assets

For September 30, 2006 and September 30, 2005, cash consists of an imprest fund of \$10 thousand.

Note 4. Investments

For September 30, 2006 and September 30, 2005 investments consist of the following:

		Cost	Unamortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value
Intragovernmental Securities:						
Non-Marketable	FY 2006	\$ 5,305,992	\$ (21,752)	\$ 38,520	\$ 5,366,264	\$ 5,366,264
Non-Marketable	FY 2005	\$ 4,762,154	\$ (16,261)	\$ 32,650	\$ 4,811,065	\$ 4,811,065

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

convert them to cash as soon as practicable. (See Note 6.) All investments in Treasury securities are earmarked funds.

Note 5. Accounts Receivable

The Accounts Receivable for September 30, 2006 and September 30, 2005, consist of the following:

	<u>FY 2006</u>	<u>FY 2005</u>
Intragovernmental Assets:		
Accounts & Interest Receivable	\$ <u>127,727</u>	\$ <u>66,060</u>
Non-Federal Assets:		
Unbilled Accounts Receivable	\$ 116,060	\$ 89,818
Accounts & Interest Receivable	364,517	1,092,376
Less: Allowance for Uncollectibles	<u>(236,753)</u>	<u>(807,526)</u>
Total	<u>\$ 243,824</u>	<u>\$ 374,668</u>

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

As of September 30, 2006, EPA reclassified \$704 million in non-federal and \$21 million in federal receivables as Currently Not Collectible (CNC).

Note 6. Other Assets

Other Assets for September 30, 2006 and 2005, consist of the following:

	<u>FY 2006</u>	<u>FY 2005</u>
Intragovernmental Assets:		
Advances to Federal Agencies \$	58,847	\$ 1,102
Advances to WCF	-	827
Advances for Postage	296	406
Total Intragovernmental Assets \$	<u>59,143</u>	<u>\$ 2,335</u>

Non-Federal Assets:		
Travel Advances \$	154	\$ (898)
Letter of Credit Advances	9	9
Grant Advances	118	1,710
Other Advances	3,249	946
Operating Materials and Supplies	183	183
Inventory for Sale	565	204
Securities Received in Settlement of Debt	-	635
Total Non-Federal Assets \$	<u>4,278</u>	<u>\$ 2,789</u>

Note 7. Loans Receivable, Net - Non-Federal

Asbestos Loan Program loans disbursed from obligations made prior to FY 1992 are net of allowances for estimated uncollectible loans, if an allowance was considered necessary. Loans disbursed from obligations made after FY 1991 are governed by the Federal Credit Reform Act, which mandates that the present value of the subsidy costs (i.e., interest rate differentials, interest subsidies, anticipated delinquencies, and defaults) associated with direct loans be recognized as an expense in the year the loan is made. The net loan present value is the gross loan receivable less the subsidy present value. The amounts as of September 30, 2006 and 2005, are as follows:

	<u>FY 2006</u>			<u>FY 2005</u>		
	<u>Loans Receivable, Gross</u>	<u>Allowance*</u>	<u>Value of Assets Related to Direct Loans</u>	<u>Loans Receivable, Gross</u>	<u>Allowance*</u>	<u>Value of Assets Related to Direct Loans</u>
Direct Loans Obligated Prior to FY 1992	\$ 12,327	\$ -	\$ 12,327	\$ 18,118	\$ -	\$ 18,118
Direct Loans Obligated After FY 1991	22,391	(3,882)	18,509	26,427	(5,198)	21,229
Total	\$ 34,718	\$ (3,882)	\$ 30,836	\$ 44,545	\$ (5,198)	\$ 39,347

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

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

	Interest Rate Re- estimate	Technical Re- estimate	Total
Upward Subsidy Reestimate - FY 2006	\$ 32	\$ 26	\$ 58
FY 2006 Totals	\$ 32	\$ 26	\$ 58
Downward Subsidy Reestimate - FY 2005	\$ (233)	\$ (203)	\$ (436)
Upward Subsidy Reestimate – FY 2005	129	128	257
FY 2005 Totals	\$ (104)	\$ (75)	\$ (179)

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, 2006 and 2005.

	<u>FY 2006</u>	<u>FY 2005</u>
Intragovernmental:		
Accounts Payable to other Federal Agencies	\$ 923	\$ 774
Liability for Allocation Transfers	20,580	19,878
Accrued Liabilities, Federal	86,022	99,184
Total Intragovernmental	\$ 107,525	\$ 119,836
Non-Federal:		
Accounts Payable, Non-Federal	\$ 106,156	\$ 105,027
Advances Payable, Non-Federal	16	24
Interest Payable	7	7
Grant Liabilities	414,112	449,206
Other Accrued Liabilities, Non-Federal	205,376	176,014
Total Non-Federal	\$ 725,667	\$ 730,278

Note 9. Property, Plant and Equipment (PP&E)

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

As of September 30, 2006 and 2005, Plant, Property and Equipment consist of the following:

	<u>FY 2006</u>			<u>FY 2005</u>		
	<u>Acquisition</u>	<u>Accumulated</u>	<u>Net Book Value</u>	<u>Acquisition</u>	<u>Accumulated</u>	<u>Net Book</u>
	<u>Value</u>	<u>Depreciation</u>		<u>Value</u>	<u>Depreciation</u>	<u>Value</u>
EPA-Held Equipment	\$ 207,328	\$ (116,228)	\$ 91,100	\$ 194,410	\$ (109,683)	\$ 84,727
Software	198,961	(37,871)	161,090	146,132	(19,777)	126,355
Contractor Held Equip.	64,757	(25,001)	39,756	56,746	(22,706)	34,040
Land and Buildings	573,887	(132,168)	441,719	558,689	(122,012)	436,677
Capital Leases	49,844	(26,715)	23,129	50,111	(23,194)	26,917
Total	\$ 1,094,777	\$ (337,983)	\$ 756,794	\$ 1,006,088	\$ (297,372)	\$ 708,716

Note 10. Debt Due to Treasury

The debt due to Treasury consists of the following as of September 30, 2006 and 2005:

All Other Funds	FY 2006			FY 2005		
	Beginning Balance	Net Borrowing	Ending Balance	Beginning Balance	Net Borrowing	Ending Balance
Intragovernmental:						
Debt to Treasury	\$ 21,744	\$ (2,848)	\$ 18,896	\$ 24,101	\$ (2,357)	\$ 21,744

Note: 11 Stewardship PP & E

The Agency acquires title to certain land and land rights under the authorities provided in Section 104 (J) CERCLA related to remedial clean-up sites. The land rights are in the form of easements to allow access to clean-up sites or to restrict usage of remediated sites. In some instances, the Agency takes title to the land during remediation and returns it to private ownership upon the completion of clean-up. A site with “land acquired” may have more than one acquisition property. Sites are not counted as a withdrawal until all acquired properties have been transferred. **For additional information on Stewardship PP & E (Land) see Required Supplementary Information Section.**

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.

Note 13. Other Liabilities

Other Liabilities consist of the following as of September 30, 2006:

	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total
	<u> </u>	<u> </u>	<u> </u>
Other Liabilities – Intragovernmental			
Current			
Employer Contributions & Payroll Taxes	\$ 13,203	\$ -	\$ 13,203
WCF Advances	11,730	-	11,730
Other Advances	8,786	-	8,786
Advances, HRSTF Cashout	38,684	-	38,684
Deferred HRSTF Cashout	53	-	53
Liability for Deposit Funds	(44)	-	(44)
Resources Payable to Treasury	29	-	29
Non-Current			
Unfunded FECA Liability	-	8,493	8,493
Payable to Treasury Judgment Fund	-	22,000	22,000
Total Intragovernmental	\$ <u>72,441</u>	\$ <u>30,493</u>	\$ <u>102,934</u>
Other Liabilities - Non-Federal			
Current			
Unearned Advances, Non-Federal	\$ 78,123	\$ -	\$ 78,123
Liability for Deposit Funds, Non-Federal	17,477	-	17,477
Non-Current			
Other Liabilities	-	280	280
Capital Lease Liability	-	35,442	35,442
Total Non-Federal	\$ <u>95,600</u>	\$ <u>35,722</u>	\$ <u>131,322</u>

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

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

Note 14. Leases

Capital Leases:

The Capital Leases:

Summary of Assets Under Capital Lease:	<u>FY 2006</u>	<u>FY 2005</u>
Real Property	\$ 40,913	\$ 40,913
Personal Property	2,494	2,761
Software License	6,437	6,437
Total	\$ 49,844	\$ 50,111
Accumulated Amortization	\$ 26,715	\$ 23,194

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

terminate in FYs 2010, 2013, and 2025. EPA also has capital leases terminating in FY 2007 for seven shuttle buses. However, during FY 2006, three of the seven shuttle buses were no longer needed and disposed of in the Fixed Asset System and General Ledger. These leases are expended out of the EPM appropriation.

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

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

<u>Future Payments Due:</u>	
Fiscal Year	Capital Leases
2007	\$ 8,275
2008	7,866
2009	6,295
2010	6,101
2011	5,714
After 5 Years	<u>59,198</u>
Total Future Minimum Lease Payments	\$ 93,449
Less: Imputed Interest	<u>(58,007)</u>
Net Capital Lease Liability	\$ <u>35,442</u>
Liabilities not Covered by Budgetary Resources (See Note 13)	\$ <u><u>35,442</u></u>

Operating Leases:

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

EPA has three direct operating leases for land and buildings housing scientific laboratories and/or computer facilities. Most of these leases include a base rental charge and escalator clauses based upon either rising operating costs and/or real estate taxes. The base operating costs are adjusted annually according to escalators in the Consumer Price Indices published by the Bureau of Labor Statistics. Two of these leases expire in FYs 2017 and 2020. A third lease, originally expired in FY 2001, was extended until FY 2007. These charges are expended from the EPM appropriation. The total minimum future operating lease costs are listed below.

	Operating Leases, Land and Buildings	
<u>Fiscal Year</u>		
2007	\$	81
2008		74
2009		74
2010		74
2011		74
Beyond 2011		550
		<hr/>
Payments	\$	927
		<hr/> <hr/>

Note 15. Pensions and Other Actuarial Liabilities

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

The FECA Actuarial Liability at September 30, 2006 and 2005, consists of the following:

	<u>FY 2006</u>	<u>FY 2005</u>
FECA Actuarial Liability	\$ 39,408	\$ 39,380

The FY 2006 present value of these estimated outflows are calculated using a discount rate of 5.17 percent in the first year, and 5.313 percent in the years thereafter. The estimated future costs are recorded as an unfunded liability.

Note 16. Cashout Advances, Superfund

Cashouts are funds received by EPA, a state, or another PRP under the terms of a settlement agreement (e.g., consent decree) to finance response action costs at a specified Superfund site. Under CERCLA Section 122(b)(3), cashout funds received by EPA are placed in site-specific, interest bearing accounts known as special accounts and are used 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 potentially responsible parties, 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.

Note 17. Unexpended Appropriations – Other Funds

As of September 30, 2006 and 2005, the Unexpended Appropriations consist of the following:

Unexpended Appropriations:	<u>FY 2006</u>	<u>FY 2005</u>
Unobligated		
Available	\$ 1,724,552	\$ 1,887,884
Unavailable	51,852	40,328
Undelivered Orders	8,523,236	9,079,377
Total	\$ <u>10,299,640</u>	\$ <u>11,007,589</u>

Note 18. Amounts Held by Treasury

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

Superfund (Unaudited)

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

The following reflects the Superfund Trust Fund maintained by Treasury as of September 30, 2006 and 2005. 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 2006	EPA	Treasury	Combined
Undistributed Balances			
Uninvested Fund Balance	\$ -	\$ 775	\$ 775
Total Undisbursed Balance	-	775	775
Interest Receivable	-	7,985	7,985
Investments, Net	2,446,467	173,069	2,619,536
Total Assets	\$ 2,446,467	\$ 181,829	\$ 2,628,296
Liabilities & Equity			
Receipts and Outlays	-	82,274	82,274
Equity	\$ 2,446,467	\$ 99,555	\$ 2,546,022
Total Liabilities and Equity	\$ 2,446,467	\$ 181,829	\$ 2,628,296
Receipts			
Corporate Environmental Cost Recoveries	\$ -	\$ 1,144	\$ 1,144
Fines & Penalties	-	59,661	59,661
Total Revenue	-	2,467	2,467
Appropriations Received	-	63,272	63,272
Interest Income	-	1,189,826	1,189,826
Total Receipts	\$ -	\$ 1,361,905	\$ 1,361,905
Outlays			
Transfers to/from EPA, Net	\$ 1,280,333	\$ (1,280,333)	\$ -
Transfers from CDC (recovery)	-	702	702
Total Outlays	1,280,333	(1,279,631)	702
Net Income	\$ 1,280,333	\$ 82,274	\$ 1,362,607

In FY 2006, the EPA received an appropriation for Superfund of \$1,207.6 million. Treasury's Bureau of Public Debt (BPD), the manager of the Superfund Trust Fund assets, records a liability to EPA for the amount of the appropriation. BPD does this to indicate those trust fund assets that have been assigned for use and, therefore, are not available for appropriation. As of September 30, 2006 and 2005, the Treasury Trust Fund has a liability to EPA for previously appropriated funds of \$2,446.5 million and \$2,204.9 million, respectively.

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

LUST (Unaudited)

LUST is supported primarily by a sales tax on motor fuels to clean up LUST waste sites. In FYs 2006 and 2005 there were no fund receipts from cost recoveries. The following represents the LUST Trust Fund as maintained by Treasury. The amounts contained in these notes have been provided by Treasury. 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 2006	<u>EPA</u>	<u>Treasury</u>	<u>Combined</u>
Undistributed Balances			
Uninvested Fund Balance	\$ -	\$ 11,750	\$ 11,750
Total Undisbursed Balance	-	11,750	11,750
Interest Receivable	-	30,535	30,535
Investments, Net	88,417	2,619,793	2,708,210
Total Assets	<u>\$ 88,417</u>	<u>\$ 2,662,078</u>	<u>\$ 2,750,495</u>
Liabilities & Equity			
Equity	\$ 88,417	\$ 2,662,078	\$ 2,750,495
Equity	<u>\$ 88,417</u>	<u>\$ 2,662,078</u>	<u>\$ 2,750,495</u>
Receipts			
Highway TF Tax	\$ -	\$ 196,371	\$ 196,371
Airport TF Tax	-	2,772	2,772
Inland TF Tax	-	404	404
Transfers from EPA	-	15,000	15,000
Refund Gasoline Tax	-	(1,453)	(1,453)
Refund Diesel Tax	-	(1,434)	(1,434)
Refund Aviation Fuel	-	(409)	(409)
Refund Aviation Tax	-	(24)	(24)
Cost Recoveries	-	-	-
Total Revenue	-	211,227	211,227
Interest Income	-	97,666	97,666
Total Receipts	<u>\$ -</u>	<u>\$ 308,893</u>	<u>\$ 308,893</u>
Outlays			
Transfers to/from EPA, Net	\$ 86,861	\$ (86,861)	\$ -
Total Outlays	<u>86,861</u>	<u>(86,861)</u>	<u>-</u>
Net Income	<u>\$ 86,861</u>	<u>\$ 222,032</u>	<u>\$ 308,893</u>

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

Note 19. Commitments and Contingencies

EPA may be a party in various administrative proceedings, legal actions and claims brought by or against it. These include:

- Various personnel actions, suits, or claims brought against the Agency by employees and others.
- Various contract and assistance program claims brought against the Agency by vendors, grantees and others.
- The legal recovery of Superfund costs incurred for pollution cleanup of specific sites, to include the collection of fines and penalties from responsible parties.
- Claims against recipients for improperly spent assistance funds which may be settled by a reduction of future EPA funding to the grantee or the provision of additional grantee matching funds.

Superfund:

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

As of September 30, 2006, there are currently three CERCLA Section 106(b) administrative claims. If the claimants are successful, the total losses on the claims could amount to approximately \$36.8 million. The Environmental Appeals Board has not yet issued final decisions on any of the administrative claims; therefore, a definite estimate of the amount of the contingent loss cannot be made. The claimants' chance of success overall is characterized as reasonably possible.

All Other Funds:

As of September 30, 2006, there are no claims which may be considered threatened litigation involving all other appropriated funds of the Agency.

Judgment Fund:

In cases that are paid by the U.S. Treasury Judgment Fund, the Agency must recognize the full cost of a claim regardless of who is actually paying the claim. Until these claims are settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for the payment, claims that are probable and estimable must be recognized as an expense and liability of the Agency. For these cases, at the time of settlement or judgment, the liability will be reduced and an imputed financing source

recognized. See Interpretation of Federal Financial Accounting Standards No. 2, "Accounting for Treasury Judgment Fund Transactions."

As of September 30, 2006, there are no material claims pending in the Treasury Judgment Fund. However, EPA has a \$22 million liability to the Treasury Judgment Fund for a payment made by the Fund to settle a contract dispute claim.

Note: 20 Earmarked Funds

	Environmental Services	LUST	Superfund	Other Earmarked Funds	Total Earmarked Funds	Earmark Eliminations
Balance Sheet as of September 30, 2006						
ASSETS						
Fund Balance with Treasury	\$ 165,722	\$ 25,497	\$ 35,086	\$ 31,444	\$ 257,749	\$ -
Investments	-	2,738,746	2,627,521	(3)	5,366,264	-
Accounts Receivable, Net	-	-	221,343	2,821	224,164	-
Other Assets	-	176	63,874	1,067	65,117	(8,601)
Total Assets	<u>\$ 165,722</u>	<u>\$ 2,764,419</u>	<u>\$ 2,947,824</u>	<u>\$ 35,329</u>	<u>\$ 5,913,294</u>	<u>\$ (8,601)</u>
LIABILITIES						
Other Liabilities	\$ -	\$ 7,094	\$ 563,759	\$ 31,753	\$ 602,606	\$ (41,931)
Total Liabilities	<u>\$ -</u>	<u>\$ 7,094</u>	<u>\$ 563,759</u>	<u>\$ 31,753</u>	<u>\$ 602,606</u>	<u>\$ (41,931)</u>
Cumulative Results of Operations	\$ 165,722	\$ 2,757,325	\$ 2,384,065	\$ 3,576	\$ 5,310,688	\$ (1,133,360)
Total Liabilities and Net Position	<u>\$ 165,722</u>	<u>\$ 2,764,419</u>	<u>\$ 2,947,824</u>	<u>\$ 35,329</u>	<u>\$ 5,913,294</u>	<u>\$ (1,175,291)</u>
Statement of Changes in Net Cost For the Period Ended September 30, 2006						
Gross Programs Costs	\$ -	\$ 75,073	\$ 1,438,109	\$ 62,435	\$ 1,575,617	\$ (27,973)
Less: Earned Revenues	-	-	321,263	35,230	356,493	-
Net Cost of Operations	<u>\$ -</u>	<u>\$ 75,073</u>	<u>\$ 1,116,846</u>	<u>\$ 27,205</u>	<u>\$ 1,219,124</u>	<u>\$ (27,973)</u>
Statement of Changes in Net Position for the Period Ended September 30, 2006						
Net Position, Beginning of Period	\$ 145,088	\$ 2,523,158	\$ 2,200,115	\$ 14,167	\$ 4,882,528	\$ -
Nonexchange Revenue	\$ 20,634	\$ 293,893	\$ 141,498	\$ -	\$ 456,025	\$ -
Other Budgetary Financing Sources	-	15,000	1,141,824	15,330	1,172,154	(1,161,333)
Other Financing Sources	-	347	17,474	1,285	19,106	-
Net Cost of Operations	-	(75,073)	(1,116,846)	(27,205)	(1,219,124)	27,973
Change in Net Position	<u>\$ 20,634</u>	<u>\$ 234,167</u>	<u>\$ 183,950</u>	<u>\$ (10,590)</u>	<u>\$ 428,161</u>	<u>\$ (1,133,360)</u>
Net Position End of Period	<u>\$ 165,722</u>	<u>\$ 2,757,325</u>	<u>\$ 2,384,065</u>	<u>\$ 3,577</u>	<u>\$ 5,310,689</u>	<u>\$ (1,133,360)</u>

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

Leaking Underground Storage Tank (LUST) Trust Fund: The LUST Trust Fund, Treasury fund group 8153, was authorized by the Superfund Amendments and Reauthorization Act of 1986 (SARA) as amended by the Omnibus Budget Reconciliation Act of 1990. The LUST appropriation provides funding to respond to releases from leaking underground petroleum tanks. The Agency oversees cleanup and enforcement programs which are implemented by the states. Funds are allocated to the states through cooperative agreements to clean up those sites posing the greatest threat to human health and the environment. Funds are used for grants to non-state entities including Indian tribes under Section 8001 of the Resource Conservation and Recovery Act. The program is financed by a one cent a gallon tax on motor fuels which will expire in 2011.

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

Other Earmarked Funds:

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

provided through the Department of Transportation under the Oil Spill Liability Trust Fund and reimbursable funding from other federal agencies.

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

Pesticide Registration Fund: The Pesticide Registration Fund authorized by a 2004 Act, “Consolidated Appropriations Act (P.L. 108-199),” Treasury fund group 5374, was authorized in 2004 for the expedited processing of certain registration petitions and associated establishment of tolerances for pesticides to be used in or on food and animal feed. Fees covering these activities, as authorized under the FIFRA Act of 1988, are to be paid by industry and deposited into this fund group.

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

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

Note 21. Exchange Revenues, Statement of Net Cost

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

Note: 22 Intragovernmental Costs and Exchange Revenue

	FY 2006			FY 2005		
	Intragovern- mental	With the Public	TOTAL	Intragovern- mental	With the Public	TOTAL
Clean Air						
Program Costs	\$ 192,774	\$ 764,539	\$ 957,313	\$ 186,667	\$ 803,822	\$ 990,489
Earned Revenue	<u>37,264</u>	<u>2,228</u>	<u>39,492</u>	<u>20,295</u>	<u>2,205</u>	<u>22,500</u>
NET COST	\$ 155,510	\$ 762,311	\$ 917,821	\$ 166,372	\$ 801,617	\$ 967,989
Clean & Safe Water						
Program Costs	\$ 137,874	\$ 3,717,427	\$ 3,855,301	\$ 209,631	\$ 3,297,570	\$ 3,507,201
Earned Revenue	<u>9,088</u>	<u>2,822</u>	<u>11,910</u>	<u>15,444</u>	<u>2,570</u>	<u>18,014</u>
NET COST	\$ 128,786	\$ 3,714,605	\$ 3,843,391	\$ 194,187	\$ 3,295,000	\$ 3,489,187
Land Preservation & Restoration						
Program Costs	\$ 448,101	\$ 1,870,476	\$ 2,318,577	\$ 376,717	\$ 1,639,157	\$ 2,015,874
Earned Revenue	<u>440,068</u>	<u>297,395</u>	<u>737,463</u>	<u>42,567</u>	<u>312,487</u>	<u>355,054</u>
NET COST	\$ 8,033	\$ 1,573,081	\$ 1,581,114	\$ 334,150	\$ 1,326,670	\$ 1,660,820
Healthy Communities & Ecosystems						
Program Costs	\$ 271,667	\$ 1,030,019	\$ 1,301,686	\$ 280,492	\$ 992,360	\$ 1,272,852
Earned Revenue	<u>37,670</u>	<u>31,080</u>	<u>68,750</u>	<u>15,638</u>	<u>32,509</u>	<u>48,147</u>
NET COST	\$ 233,997	\$ 998,939	\$ 1,232,936	\$ 264,854	\$ 959,851	\$ 1,224,705
Compliance & Environmental Stewardship						
Program Costs	\$ 183,628	\$ 598,997	\$ 782,625	\$ 174,321	\$ 539,857	\$ 714,178
Earned Revenue	<u>9,998</u>	<u>2,149</u>	<u>12,147</u>	<u>12,000</u>	<u>1,353</u>	<u>13,353</u>
NET COST	\$ 173,630	\$ 596,848	\$ 770,478	\$ 162,321	\$ 538,504	\$ 700,825
Not Assigned						
Program Costs	\$ -	\$ -	\$ -	\$ 10,567	\$ (13,739)	\$ (3,172)
Earned Revenue	<u>-</u>	<u>-</u>	<u>-</u>	<u>(291)</u>	<u>6,700</u>	<u>6,409</u>
NET COST	\$ -	\$ -	\$ -	\$ 10,858	\$ (20,439)	\$ (9,581)
Total						
Program Costs	\$ 1,234,044	\$ 7,981,458	\$ 9,215,502	\$ 1,238,395	\$ 7,259,027	\$ 8,497,422
Earned Revenue	<u>534,088</u>	<u>335,674</u>	<u>869,762</u>	<u>105,653</u>	<u>357,824</u>	<u>463,477</u>
NET COST	\$ <u>699,956</u>	\$ <u>7,645,784</u>	\$ <u>8,345,740</u>	\$ <u>1,132,742</u>	\$ <u>6,901,203</u>	\$ <u>8,033,945</u>

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

Note 23. Cost of Stewardship PP&E

The costs related to the acquisition of stewardship land in FY 2006 were approximately \$1 million. These costs are included in the Statement of Net Cost.

Note 24. Environmental Cleanup Costs

As of September 30, 2006, EPA has four sites that require clean up stemming from its activities. Costs amounting to \$110.9 thousand may be paid out of the Treasury Judgment

Fund. (The \$110.9 thousand represents the lower end of a range estimate, of which the maximum of the range will total \$212.9 thousand.) Two claimants' chance of success is characterized as reasonably possible and one as probable (settled July 11, 2006 for \$7.9 thousand). Additionally EPA has one site (\$80 thousand) characterized as remote chance of success. EPA also holds title to a site in Edison, New Jersey which was formerly an Army Depot. While EPA did not cause the contamination, the Agency could potentially be liable for a portion of the cleanup costs. However, it is expected that the Department of Defense and General Services Administration will bear all or most of the cost of remediation. In addition, EPA has 2 sites that have an unfunded environmental liability of \$280 thousand.

Accrued Cleanup Cost:

The EPA has 15 sites that will require future clean up associated with permanent closure. The estimated costs will be approximately \$10 million. Since the cleanup costs associated with permanent closure are not primarily recovered through user fees, EPA has elected to recognize the estimated total cleanup cost as a liability and record changes to the estimate in subsequent years.

The FY 2006 estimate for unfunded cleanup costs increased by \$3 million from the FY 2005 estimate. This increase is due primarily to new estimated costs for cleanup at two sites.

Note 25. 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, 2006, the total remaining state credits have been estimated at \$17.1 million. The estimated ending credit balance on September 30, 2005 was \$10.1 million.

Note 26. Preauthorized Mixed Funding Agreements

Under Superfund preauthorized mixed funding agreements, PRPs agree to perform response actions at their sites with the understanding that EPA will reimburse the PRPs a certain percentage of their total response action costs. EPA's authority to enter into mixed funding agreements is provided under CERCLA Section 111(a)(2). Under CERCLA Section 122(b)(1), as amended by SARA, PRPs may assert a claim against the Superfund Trust Fund for a portion of the costs they incurred while conducting a preauthorized response action agreed to under a mixed funding agreement. As of September 30, 2006, EPA had 15 outstanding preauthorized mixed funding agreements with obligations totaling \$31 million. A liability is not recognized for these amounts until all work has been performed by the PRP and has been approved by EPA for payment. Further, EPA will not disburse any funds under these agreements until the PRP's application, claim, and claims adjustment processes have been reviewed and approved by EPA.

Note 27. Custodial Revenues and Accounts Receivable

	<u>FY 2006</u>	<u>FY 2005</u>
Fines, Penalties and Other Miscellaneous Receipts	\$ <u>19,570</u>	\$ <u>150,816</u>
Accounts Receivable for Fines, Penalties and Other Miscellaneous Receipts:		
Accounts Receivable	\$ 155,023	\$ 167,533
Less: Allowance for Uncollectible Accounts	<u>(122,064)</u>	<u>(51,954)</u>
Total	<u>\$ 32,959</u>	<u>\$ 115,579</u>

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

Note 28. Statement of Budgetary Resources

Budgetary resources, obligations incurred, and outlays, as presented in the audited FY 2006 Statement of Budgetary Resources, will be reconciled to the amounts included in the FY 2008 Budget of the United States Government when they become available. The Budget of the United States Government with actual numbers for FY 2006 has not yet been published. We expect it will be published by March 2007, and it will be available on the OMB website at <http://www.whitehouse.gov/omb/budget/fy2008>. The actual amounts published for the year ended September 30, 2005 are included in EPA's FY 2006 financial statement disclosures.

FY 2005	Budgetary Resources	Obligations	Offsetting Receipts	Net Outlays
Statement of Budgetary Resources	\$ 13,231,189	10,124,433	\$ 1,334,508	\$ 9,254,011
Funds Reported by Other Federal Entities	19,285	4,576		5,329
Adjustments to Unliquidated Obligations, Unfilled Customer Orders and Other	7,348	1,586		
Less: 1993 Superfund Cost Recovery	(1,970)		(1,970)	
Plus: Funds received in a receipt account transferred to "no year" account			10,780	
Expired and Immaterial Funds*	(100,687)	(3,312)		
Rounding Differences**	(2,165)	(1,283)	(318)	660
Reported in Budget of the U. S. Government	\$ 13,153,000	\$ 10,126,000	\$ 1,343,000	\$ 9,260,000

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

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

Note 29. Recoveries and Resources Not Available, Statement of Budgetary Resources

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

	<u>FY 2006</u>	<u>FY 2005</u>
Recoveries of Prior Year Obligations- downward adjustments of prior years'	\$ <u>264,710</u>	\$ <u>174,641</u>
Temporarily Not Available-rescinded authority	<u>(9,466)</u>	<u>(11,141)</u>
Permanently Not Available:		
Payments to Treasury	(2,848)	(2,793)
Rescinded authority	(185,472)	(64,018)
Canceled authority	<u>(10,164)</u>	<u>(11,433)</u>
Total Permanently Not Available	\$ <u>(198,484)</u>	\$ <u>(78,244)</u>

Note 30. Unobligated Balances Available

The availability of unobligated balances consists of the following as of September 30, 2006 and 2005. Unexpired unobligated balances are available to be apportioned by the OMB for new obligations at the beginning of the following fiscal year. The expired unobligated balances are only available for upward adjustments of existing obligations.

	<u>FY 2006</u>	<u>FY 2005</u>
Unexpired Unobligated Balance	\$ 3,156,100	\$ 3,011,341
Expired Unobligated Balance	90,987	95,415
Total	\$ <u>3,247,087</u>	\$ <u>3,106,756</u>

Note 31 . Undelivered Orders at The End of the Period

Budgetary resources obligated for undelivered orders at the end of the September 30, 2006 and 2005 are as follows:

	<u>FY 2006</u>	<u>FY 2005</u>
Undelivered Orders \$	10,000,509 \$	10,636,009

Note 32. Offsetting Receipts

Distributed offsetting receipts credited to the general fund, special fund, or trust fund receipt accounts offset gross outlays. For FYs 2006 and 2005, the following receipts were generated from these activities:

	<u>FY 2006</u>	<u>FY 2005</u>
Trust Fund Recoveries	\$ 59,748	\$ 66,419
Special Fund Environmental Service	20,634	20,176
Downward Re-estimates of Subsidies	-	436
Trust Fund Appropriation	1,204,825	1,247,477
Treasury Specified Miscellaneous Receipts and Clearing Accounts	29,573	-
Total	<u><u>\$ 1,314,780</u></u>	<u><u>\$ 1,334,508</u></u>

Note 33. Statement of Financing

Specific components requiring or generating resources in future periods and resources that fund expenses recognized in prior periods are related to changes in liabilities not covered by budgetary resources. For FYs 2006 and 2005, the following line items are reconciled to the increases or decreases in those liabilities.

	<u>FY 2006</u>	<u>FY 2005</u>
Statement of Financing Lines:		
Resources that fund prior period expenses	\$ (2,020)	\$ (1,120)
Components requiring or generating resources in future periods:		
Increases in environmental liabilities	3,352	99
Increase in unfunded contingencies	-	1,525
Increase in annual leave liabilities	4,776	3,889
Up/downward re-estimates of subsidy exp.	-	3
Increase in Workers Compensation Costs	37	-
Total	<u><u>\$ 6,145</u></u>	<u><u>\$ 4,396</u></u>
 Increases (Decreases) in Liabilities Not Covered by Budgetary Resources and Reconciling Items		
Unfunded Annual Leave Liability	\$ 4,776	\$ 4,092
Unfunded Contingent Liability	(1,942)	325
Unfunded Judgment Fund Liability	-	-
Unfunded Workers Compensation Liability	9	(220)
Actuarial Workers Compensation Liability	28	(901)
Unfunded Clean-up Costs Liability	3,094	1,269
Unfunded Environmental Liability	250	30
Subsidy re-estimates	(70)	(199)
Total	<u><u>\$ 6,145</u></u>	<u><u>\$ 4,396</u></u>

Note 34. Costs Not Assigned to Goals

In FY 2006, there are no unassigned costs. All costs are now being allocated to the program/project level based on established business rules. For Net Cost by Goals, program/project costs are rolled-up to the five designated EPA environmental goals.

FY 2005's Statement of Net Cost by Goal had \$3 million in gross costs not assigned to goals. This amount is comprised of decreases of \$0.2 million in overhead costs, \$22 million in operating expenses, \$0.7 million in unfunded expenses; offset by increases of \$16 million in undistributed payroll costs, \$0.3 million in depreciation expenses, \$0.6 million in other expenses, and \$3 million in loss on disposition of assets.

Note 35. Transfers-In and Out, Statement of Changes in Net Position

Appropriation Transfers, In/Out:

For FYs 2006 and 2005, the Appropriation Transfers under Budgetary Financing Sources on the Statement of Changes in Net Position are comprised of nonexpenditure transfers that affect Unexpended Appropriations for non-invested appropriations. These amounts are

included in the Budget Authority, Net Transfers and Prior Year Unobligated Balance, Net Transfers lines on the Statement of Budgetary Resources. Detail of the Appropriation Transfers on the Statement of Changes in Net Position and a reconciliation with the Statement of Budgetary Resources follow:

Transfers In/Out Without Reimbursement, Budgetary:

Fund/Type of Account	<u>FY 2006</u>	<u>FY 2005</u>
Department of State	\$ 1,500	\$ -
Appalachian Regional Commission	(747)	-
S & T	-	(992)
EPM	-	5,694
Total Appropriation Transfers	\$ <u>753</u>	\$ <u>4,702</u>
Net Transfers from Invested Funds	1,248,523	1,328,667
Transfers to Other Agencies	-	4,736
Allocations Rescinded	<u>8,932</u>	<u>10,620</u>
Total of Net Transfers on Statement of Budgetary Resources	\$ <u><u>1,258,208</u></u>	\$ <u><u>1,348,725</u></u>

For FYs 2006 and 2005 Transfers In/Out under Budgetary Financing Sources on the Statement of Changes in Net Position consist of transfers to or from other federal agencies and between EPA funds. These transfers affect Cumulative Results of Operations. Detail of the transfers-in and transfers-out, expenditure and nonexpenditure, follows:

Type of Transfer/Funds	<u>FY 2006</u>	<u>FY 2005</u>
Transfers-out, nonexpenditure to other federal agencies	\$ (4,636)	\$ (4,736)
Transfers-in, nonexpenditure, Oil Spill	<u>15,330</u>	<u>15,872</u>
Total Transfers in (out) without Reimbursement, Budgetary	\$ <u><u>10,694</u></u>	\$ <u><u>11,136</u></u>

Transfers In/Out without Reimbursement, Other Financing Sources:

For FYs 2006 and 2005 Transfers In/Out without Reimbursement under Other Financing Sources on the Statement of Changes in Net Position are comprised of negative subsidy to a special receipt fund for the credit reform funds. The amounts reported on the Statement of Changes in Net Position are as follows:

Type of Transfer/Funds	<u>FY 2006</u>	<u>FY 2005</u>
Transfers-in (out) of prior year negative subsidy to be paid following year	<u>(28)</u>	<u>436</u>
Total Transfers in (out) without Reimbursement, Budgetary	<u>\$ (28) \$</u>	<u>436</u>

Note 36. Imputed Financing Sources

In accordance with SFFAS No. 5, "Liabilities of the Federal Government," federal agencies must recognize the portion of employees' pensions and other retirement benefits to be paid by the OPM trust funds. These amounts are recorded as imputed costs and imputed financing for each agency. Each year the OPM provides federal agencies with cost factors to calculate these imputed costs and financing that apply to the current year. These cost factors are multiplied by the current year's salaries or number of employees, as applicable, to provide an estimate of the imputed financing that the OPM trust funds will provide for each agency. The estimates for FY 2006 were \$131.1 million. For FY 2005, the estimates were \$129.7 million.

In addition to the pension and retirement benefits described above, EPA also records imputed costs and financing for Treasury Judgment Fund payments on behalf of the agency. Entries are made in accordance with the Interpretation of Federal Financial Accounting Standards No. 2, "Accounting for Treasury Judgment Fund Transactions." For FY 2006 entries for Judgment Fund payments totaled \$9.4 million. For FY 2005, entries for Judgment Fund payments totaled \$8.4 million.

Note 37. Payroll and Benefits Payable

Payroll and benefits payable to EPA employees for the years ending September 30, 2006 and 2005, consist of the following:

FY 2006 Payroll & Benefits Payable	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total
Accrued Funded Payroll & Benefits	\$ 31,023	\$ -	\$ 31,023
Withholdings Payable	27,653	-	27,653
Employer Contributions Payable-TSP	2,010	-	2,010
Accrued Unfunded Annual Leave	-	135,060	135,060
Total - Current	\$ 60,686	\$ 135,060	\$ 195,746

FY 2005 Payroll & Benefits Payable	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total
Accrued Funded Payroll & Benefits	\$ 30,881	\$ -	\$ 30,881
Withholdings Payable	26,977	-	26,977
Employer Contributions Payable-TSP	1,896	-	1,896
Other Post-employment Benefits Payable	36	-	36
Accrued Funded Leave, WCF	320	-	320
Accrued Unfunded Annual Leave	-	130,284	130,284
Total - Current	\$ 60,110	\$ 130,284	\$ 190,394

Note 38. 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 five years earlier. These amounts affect Unexpended Appropriations.

	<u>FY 2006</u>	<u>FY 2005</u>
Rescissions to General Appropriations	\$ 185,472	\$ 64,017
Canceled General Authority	10,146	11,433
Total Other Adjustments	\$ 195,618	\$ 75,450

Note 39. Nonexchange Revenue, Statement of Changes in Net Position

The Nonexchange Revenue, Budgetary Financing Sources, on the Statement of Changes in Net Position for FYs 2006 and 2005 consists of the following items:

	<u>FY 2006</u>	<u>FY 2005</u>
Interest on Trust Fund	\$ 206,474	\$ 130,206
Tax Revenue, Net of Refunds	197,371	194,786
Fines and Penalties Revenue	31,422	(26,506)
Special Receipt Fund Revenue	20,758	20,176
Revenue	\$ 456,025	\$ 318,662

Note 40. Other, Statement of Financing

The “Other” balance on the Statement of Financing of \$1.8 million for FY 2006 and \$1.9 million for FY 2005 represent a portion of the 1993 Cost Recovery received from the Uniroyal bankruptcy judgment that was transferred from the Treasury Managed Receipt Account 20X8145.4 to the Superfund Trust Account 68-20X8145. The transfer was necessary in order to execute expenditures from consent decrees.

1.
Environmental Protection Agency
Required Supplementary Information
As of September 30, 2006
(Dollars in Thousands)
(Unaudited)

Deferred Maintenance

The EPA classifies tangible property, plant, and equipment as follows: (1) EPA-Held Equipment, (2) Contractor-Held Equipment, (3) Land and Buildings, and, (4) Capital Leases. The condition assessment survey method of measuring deferred maintenance is utilized. The Agency adopts requirements or standards for acceptable operating condition in conformance with industry practices. No deferred maintenance was reported for any of the four categories.

2.
Environmental Protection Agency
Required Supplementary Information
Supplemental Statement of Budgetary Resources (Unaudited)
As of September 30, 2006
(Dollars in Thousands)

	EPM	FIFRA	LUST	S&T	STAG	OTHER	TOTAL
BUDGETARY RESOURCE							
Unobligated Balance Brought Forward, October 1	\$ 371,613	\$ 5,016	\$ 5,460	\$ 238,199	\$ 1,469,949	\$ 1,016,519	\$ 3,106,756
Recoveries of prior year unpaid obligations	19,068	894	9,016	6,743	102,574	126,415	264,710
Budgetary Authority:							-
Appropriation	2,387,752	-	15,000	741,722	3,261,696	1,422,231	7,828,401
Spending Authority from Offsetting Collections:							-
Collected	388,338	26,866	113	7,385	6,910	500,805	930,417
Change in receivables from Federal sources	87,353	-	-	(143)	27	85	87,322
Advance received	2,170	(437)	-	1,948	-	(12,298)	(8,617)
Without advance from Federal source	183,370	-	-	(1,342)	(27)	(32,394)	149,607
Expenditure Transfers from trust funds	-	-	-	30,156	-	13,210	43,366
Nonexpenditure transfers, net anticipated and actual	1,500	-	73,026	-	-	1,183,682	1,258,208
Temporarily not available pursuant to Public Law	-	-	(1,165)	-	-	(8,301)	(9,466)
Permanently not available	(40,272)	-	-	(15,171)	(120,602)	(22,439)	(198,484)
Total Budgetary Resources	\$ 3,400,892	\$ 32,339	\$ 101,450	\$ 1,009,497	\$ 4,720,527	\$ 4,187,515	\$ 13,452,220
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred:							
Direct	\$ 2,334,104	\$ -	\$ 86,183	\$ 797,536	\$ 3,409,715	\$ 2,664,877	\$ 9,292,415
Reimbursable	500,573	26,693	-	6,169	-	379,283	912,718
Total Obligations Incurred	2,834,677	26,693	86,183	803,705	3,409,715	3,044,160	10,205,133
Unobligated Balances:							
Unobligated funds apportioned	498,955	5,646	15,267	185,284	1,310,812	1,140,136	3,156,100
Unobligated balance not available	67,260	-	-	20,508	-	3,219	90,987
Total Status of Budgetary Resources	\$ 3,400,892	\$ 32,339	\$ 101,450	\$ 1,009,497	\$ 4,720,527	\$ 4,187,515	\$ 13,452,220
CHANGE IN OBLIGATED BALANCE							
Obligated Balance, Net							
Unpaid obligations brought forward, October 1	\$ 945,687	\$ 2,949	\$ 84,528	\$ 627,792	\$ 8,251,146	\$ 1,710,996	\$ 11,623,098
Less: Uncollected customer payments from Federal sources brought forward, October 1	(275,461)	-	-	(54,827)	-	(156,697)	(486,985)
Total unpaid obligation balance, net	670,226	2,949	84,528	572,965	8,251,146	1,554,299	11,136,113
Obligations incurred, net	2,834,676	26,694	86,184	803,706	3,409,714	3,044,159	10,205,133
Less: Gross outlays	(2,771,891)	(26,322)	(76,253)	(837,997)	(3,883,505)	(3,011,227)	(10,607,195)
Less: Recoveries of prior year unpaid obligations, actual	(19,068)	(895)	(9,016)	(6,742)	(102,574)	(126,415)	(264,710)
Change in uncollected customer payments from Federal sources	(270,722)	-	-	12,531	-	32,939	(225,252)
Total	443,221	2,426	85,443	544,463	7,674,781	1,493,755	10,244,089
Obligated balance, net, end of period:							
Unpaid obligations	989,405	2,426	85,443	586,759	7,674,781	1,617,514	10,956,328
Less: Uncollected customer payments from Federal sources	(546,184)	-	-	(42,296)	-	(123,759)	(712,239)
Total, unpaid obligated balance, net, end of period	\$ 443,221	\$ 2,426	\$ 85,443	\$ 544,463	\$ 7,674,781	\$ 1,493,755	\$ 10,244,089
NET OUTLAYS							
Gross outlays	\$ 2,771,891	\$ 26,322	\$ 76,254	\$ 837,996	\$ 3,883,505	\$ 3,011,227	\$ 10,607,195
Less: Offsetting collections	(390,508)	(26,429)	(115)	(50,536)	(6,910)	(502,345)	(976,843)
Less: Distributed Offsetting Receipts	-	-	-	-	-	(1,314,780)	(1,314,780)
Total, Net Outlays	\$ 2,381,383	\$ (107)	\$ 76,139	\$ 787,460	\$ 3,876,595	\$ 1,194,102	\$ 8,315,572

3.
Environmental Protection Agency
Required Supplementary Information (Unaudited)
For the Year Ended September 30, 2006
(Dollars in Thousands)

STEWARDSHIP PP&E (LAND)

The Agency acquires title to certain land and land rights under the authorities provided in Section 104 (J) CERCLA related to remedial clean-up sites. The land rights are in the form of easements to allow access to clean-up sites or to restrict usage of remediated sites. In some instances, the Agency takes title to the land during remediation and returns it to private ownership upon the completion of clean-up. A site with “land acquired” may have more than one acquisition property. Sites are not counted as a withdrawal until all acquired properties have been transferred.

As of September 30, 2006, the Agency possesses the following land and land rights:

Superfund Sites with Easements

Beginning Balance	33
Additions	0
Withdrawals	<u>1</u>
Ending Balance	<u>32</u>

Superfund Sites with Land Acquired

Beginning Balance	29
Additions	2
Withdrawals	<u>0</u>
Ending Balance	<u>31</u>

**Environmental Protection Agency
 Required Supplementary Stewardship Information (Unaudited)
 For the Year Ended September 30, 2006
 (Dollars in Thousands)**

INVESTMENT IN THE NATION’S RESEARCH AND DEVELOPMENT: (Non-Federal Physical Property):

Public and private sector institutions have long been significant contributors to our nation’s environment and human health research agenda. EPA’s Office of Research and Development, however, is unique among scientific institutions in this country in combining research, analysis, and the integration of scientific information across the full spectrum of health and ecological issues and across the risk assessment and risk management paradigm. Research enables us to identify the most important sources of risk to human health and the environment, and by so doing, informs our priority-setting, ensures credibility for our policies, and guides our deployment of resources. It gives us the understanding and technologies we need to detect, abate, and avoid environmental problems. Research also provides the crucial underpinning(s) for EPA decisions and challenges us to apply the best available science and technical analysis to our environmental problems and to practice more integrated, efficient and effective approaches to reducing environmental risks.

Among the Agency’s highest priorities are research programs that address the environmental effects on children’s health; the development of alternative techniques for prioritizing chemicals for further testing through computational toxicology; the provision of near-term, appropriate, affordable, reliable, tested, and effective technologies and guidance for potential threats to homeland security; the potential risks of unregulated contaminants in drinking water; the health effects of air pollutants such as particulate matter; and the protection of the nation’s ecosystems. For FY 2006, the full cost of the Agency’s Research and Development activities totaled over \$734.6 million. Below is a breakout of the expenses (dollars in thousands):

	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 2006</u>
Programmatic Expenses	\$559,218	\$593,295	\$581,323	\$628,467	\$630,438
Allocated Expenses	\$123,307	\$106,971	\$91,675	\$112,558	\$104,167

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

INVESTMENT IN THE NATION’S INFRASTRUCTURE:

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

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

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

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

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

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

	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 2006</u>
Construction Grants	\$149,841	\$15,845	\$48,948	\$21,148	\$39,193
Clean Water SRF	\$1,389,048	\$1,295,394	\$1,407,345	\$1,127,883	\$1,339,702
Safe Drinking Water SRF	\$708,528	\$842,936	\$802,629	\$715,060	\$910,032
Other Infrastructure Grants	\$367,259	\$582,091	\$341,767	\$385,226	\$411,023
Allocated Expenses	\$576,536	\$493,349	\$410,129	\$402,853	\$446,113

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):

	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 2006</u>
Training and Awareness Grants	\$49,444	\$47,827	\$48,416	\$46,750	\$43,765
Fellowships	\$8,728	\$6,572	\$7,553	\$10,195	\$12,639
Allocated Expenses	\$12,827	\$9,808	\$8,826	\$10,199	\$9,320

1.
Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Balance Sheet For Superfund Trust Fund
For the Periods Ending September 30, 2006 and 2005
(Dollars in Thousands)

	<u>FY 2006</u>	<u>FY 2005</u>
ASSETS		
Intragovernmental:		
Fund Balance With Treasury (Note S1)	\$ 35,086	\$ 213,797
Investments	2,627,521	2,297,193
Accounts Receivable, Net	8,012	28,160
Other	8,191	9,859
Total Intragovernmental	<u>\$ 2,678,810</u>	<u>\$ 2,549,009</u>
Accounts Receivable, Net	213,331	260,736
Property, Plant & Equipment, Net	54,917	49,530
Other	766	1,533
Total Assets	<u>\$ 2,947,824</u>	<u>\$ 2,860,808</u>
LIABILITIES		
Intragovernmental:		
Accounts Payable and Accrued Liabilities	84,706	105,386
Custodial Liability	-	26,763
Other	44,324	46,809
Total Intragovernmental	<u>\$ 129,030</u>	<u>\$ 178,958</u>
Accounts Payable & Accrued Liabilities	\$ 122,788	\$ 126,898
Pensions & Other Actuarial Liabilities	6,925	7,037
Cashout Advances, Superfund (Note S2)	223,760	270,811
Payroll & Benefits Payable	34,969	33,597
Other	46,287	43,392
Total Liabilities	<u>\$ 563,759</u>	<u>\$ 660,693</u>
NET POSITION		
Cumulative Results of Operations	<u>2,384,065</u>	<u>2,200,115</u>
Total Net Position	<u>2,384,065</u>	<u>2,200,115</u>
Total Liabilities and Net Position	<u>\$ 2,947,824</u>	<u>\$ 2,860,808</u>

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Statement of Net Cost for Superfund Trust Fund
For the Periods Ending September 30, 2006 and 2005
(Dollars in Thousands)

		<u>FY 2006</u>		<u>FY 2005</u>
COSTS				
Gross Costs	\$	1,438,109	\$	1,580,848
Expenses from Other Appropriations (S5)		<u>61,635</u>		<u>90,167</u>
Total Costs		1,499,744		1,671,015
Less:				
Earned Revenue		<u>321,263</u>		<u>336,879</u>
NET COST OF OPERATIONS	\$	<u><u>1,178,481</u></u>	\$	<u><u>1,334,136</u></u>

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Statement of Changes in Net Position for Superfund Trust Fund
For the Periods Ending September 30, 2006 and 2005
(Dollars in Thousands)

	FY2006	FY 2005
	Cumulative Results of Operations	Cumulative Results of Operations
	<u> </u>	<u> </u>
Net Position - Beginning of Period	\$ 2,200,115	\$ 2,199,969
Beginning Balances, as Adjusted	\$ 2,200,115	\$ 2,199,969
Budgetary Financing Sources:		
Nonexchange Revenue	141,498	29,697
Transfers In/Out	(48,002)	(53,418)
Trust Fund Appropriations	1,189,826	1,247,477
Income from Other Appropriations (Note S5)	61,635	90,167
Total Budgetary Financing Sources	\$ 1,344,957	\$ 1,313,923
Other Financing Sources (Non-Exchange)		
Imputed Financing Sources	17,474	20,359
Total Other Financing Sources	\$ 17,474	\$ 20,359
Net Cost of Operations	(1,178,481)	(1,334,136)
Net Change	183,950	146
Cumulative Results of Operations	<u><u>\$ 2,384,065</u></u>	<u><u>\$ 2,200,115</u></u>

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Statement of Budgetary Resources for Superfund Trust Fund
For the Periods Ending September 30, 2006 and 2005
(Dollars in Thousands)

	FY 2006	FY 2005
BUDGETARY RESOURCES		
Unobligated Balance, Brought Forward, October 1:	\$ 930,392	\$ 823,713
Recoveries of Prior Year Unpaid Obligations	121,664	104,852
Budgetary Authority:		
Appropriation	92,269	
Spending Authority from Offsetting Collections		
Earned:		
Collected	289,736	250,487
Change in Receivables from Federal Sources	54	648
Change in Unfilled Customer Orders:		
Advance Received	(18,990)	25,798
Without Advance from Federal Sources	3,693	5,789
Total Spending Authority from Offsetting Collections	274,493	282,722
Nonexpenditure Transfers, Net, Anticipated and Actual	1,184,428	1,274,023
Temporarily Not Available Pursuant to Public Law	(7,767)	(10,060)
Permanently Not Available	(19)	-
Total Budgetary Resources	\$ 2,595,460	\$ 2,475,250

STATUS OF BUDGETARY RESOURCES

Obligations Incurred:		
Direct	\$ 1,337,854	\$ 1,369,647
Reimbursable	169,218	175,211
Total Obligations Incurred	1,507,072	1,544,858
Unobligated Balances:		
Apportioned	1,088,388	930,373
Total Unobligated Balances	1,088,388	930,373
Unobligated Balances Not Available	-	19
Total Status of Budgetary Resources (Note S6)	\$ 2,595,460	\$ 2,475,250

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Statement of Budgetary Resources for Superfund Trust Fund
For the Periods Ending September 30, 2006 and 2005
(Dollars in Thousands)

	<u>FY 2006</u>	<u>FY 2005</u>
CHANGE IN OBLIGATED BALANCE		
Obligated Balance, Net:		
Unpaid Obligations, Brought Forward, October 1	\$ 1,546,186	\$ 1,641,157
Less: Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	<u>(78,234)</u>	<u>(71,797)</u>
Total Unpaid Obligated Balance, Net	1,467,952	1,569,360
Obligations Incurred	1,507,072	1,544,858
Less: Gross Outlays	(1,477,100)	(1,534,977)
Less: Recoveries of Prior Year Unpaid Obligations, Actual	(121,664)	(104,852)
Change in Uncollected Customer Payments from Federal Sources	<u>(3,748)</u>	<u>(6,438)</u>
Total, Change in Obligated Balance	1,372,512	1,467,951
Obligated Balance, Net, End of Period:		
Unpaid Obligations	1,454,494	1,546,186
Less: Uncollected Customer Payments from Federal Sources	<u>(81,983)</u>	<u>(78,235)</u>
Total, Unpaid Obligated Balance, Net, End of Period	\$ 1,372,511	\$ 1,467,951
 NET OUTLAYS		
Net Outlays:		
Gross Outlays	\$ 1,477,100	\$ 1,534,977
Less: Offsetting Collections	(270,746)	(276,285)
Less: Distributed Offsetting Receipts	<u>(59,748)</u>	<u>(64,964)</u>
Total, Net Outlays (Note S6)	\$ 1,146,606	\$ 1,193,728

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Statement of Financing for Superfund Trust Fund
For the Periods Ending September 30, 2006 and 2005
(Dollars in Thousands)

	FY 2006	FY 2005
RESOURCES USED TO FINANCE ACTIVITIES:		
Budgetary Resources Obligated		
Obligations Incurred	\$ 1,507,072	\$ 1,544,858
Less: Spending Authority from Offsetting Collections and Recoveries	(396,158)	(387,574)
Obligations, Net of Offsetting Collections	\$ 1,110,914	\$ 1,157,284
Less: Offsetting Receipts	(59,748)	(64,964)
Net Obligations	\$ 1,051,166	\$ 1,092,320
Other Resources		
Imputed Financing Sources	17,474	20,359
Income from Other Appropriations (Note S5)	61,635	90,167
Net Other Resources Used to Finance Activities	\$ 79,109	\$ 110,526
 Total Resources Used To Finance Activities	 \$ 1,130,275	 \$ 1,202,846
RESOURCES USED TO FINANCE ITEMS		
NOT PART OF THE NET COST OF OPERATIONS:		
Change in Budgetary Resources Obligated	\$ 53,253	\$ 82,049
Resources that Fund Prior Periods Expenses	(136)	(278)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations:		
Offsetting Receipts Not Affecting Net Cost	59,748	64,964
Resources that Finance Asset Acquisition	(18,938)	(17,588)
Adjustments to Expenditure Transfers that Do Not Affect Net Cost	(43,366)	(48,682)
 Total Resources Used to Finance Items Not Part of the Net Cost of Operations	 \$ 50,561	 \$ 80,465
 Total Resources Used to Finance the Net Cost of Operations	 \$ 1,180,836	 \$ 1,283,311

**Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Statement of Financing for Superfund Trust Fund
For the Periods Ending September 30, 2006 and 2005
(Dollars in Thousands)**

	<u>FY 2006</u>	<u>FY 2005</u>
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	\$ 978	\$ 990
Increase in Public Exchange Revenue Receivables	(36,455)	(87,714)
Other (Note S8)	<u>1,823</u>	<u>1,969</u>
Total Components of Net Cost of Operations that Require or Generate Resources in Future Periods	\$ (33,654)	\$ (84,755)
Components Not Requiring/Generating Resources:		
Depreciation and Amortization	\$ 9,828	\$ 7,849
Expenses Not Requiring Budgetary Resources	21,471	127,730
Total Components of Net Cost that Will Not Require or Generate Resources	<u>\$ 31,299</u>	<u>\$ 135,579</u>
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	<u>\$ (2,355)</u>	<u>\$ 50,824</u>
Net Cost of Operations	<u><u>\$ 1,178,481</u></u>	<u><u>\$ 1,334,136</u></u>

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

Note S1. Fund Balance with Treasury for Superfund Trust

Fund Balances with Treasury as of September 30, 2006 and 2005 consist of the following:

	<u>FY 2006</u>	<u>FY 2005</u>
Fund Balance	\$ 35,086	\$ 213,797

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

Status of Fund Balances:	<u>FY 2006</u>	<u>FY 2005</u>
Unobligated Amounts in Fund Balances:		
Available for Obligation	\$ 1,088,389	\$ 930,373
Unavailable for Obligations	-	19
Net Receivables from Invested Balances	(2,426,589)	(2,191,759)
Balances in Treasury Trust Fund	775	7,212
Obligated Balance not yet Disbursed	<u>1,372,511</u>	<u>1,467,952</u>
Totals	<u>\$ 35,086</u>	<u>\$ 213,797</u>

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

Note S2. Cashout Advances, Superfund

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

Note S3. Superfund State Credits

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

Once EPA has reviewed and approved a state's claim for credit, the state must first apply the credit at the site where it was earned. The state may apply any excess/remaining credit to another site when approved by EPA. As of September 30, 2006, the total remaining state credits have been estimated at \$16.5 million. The estimated ending credit balance on September 30, 2005 was \$10.1 million.

Note S4. Superfund Preauthorized Mixed Funding Agreements

Under Superfund preauthorized mixed funding agreements, PRPs agree to perform response actions at their sites with the understanding that EPA will reimburse the PRPs a certain percentage of their total response action costs. EPA's authority to enter into mixed funding agreements is provided under CERCLA Section 111(a)(2). Under CERCLA Section 122(b)(1), as amended by SARA, PRPs may assert a claim against the Superfund Trust Fund for a portion of the costs they incurred while conducting a preauthorized response action agreed to under a mixed funding agreement. As of September 30, 2006, EPA had 15 outstanding preauthorized mixed funding agreements with obligations totaling \$31 million. A liability is not recognized for these amounts until all work has been performed by the PRP and has been approved by EPA for payment. Further, EPA will not disburse any funds under these agreements until the PRP's application, claim, and claims adjustment processes have been reviewed and approved by EPA.

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

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

During FYs 2006 and 2005, 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 2006			FY 2005		
	Income from Other Appropriations	Expenses from Other Appropriations	Net Effect	Income from Other Appropriations	Expenses from Other Appropriations	Net Effect
Superfund	\$ 61,635	\$ (61,635)	\$ -	\$ 90,167	\$ (90,167)	\$ -
All Others	(61,635)	61,635	-	(90,167)	90,167	-
Total	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

In addition, the related general support services costs allocated to the Superfund Trust Fund from the S&T and EPM funds are \$3 million for FY 2006 and \$6.9 million for FY 2005.

Note S6. Statement of Budgetary Resources, Superfund

Budgetary resources, obligations incurred, and outlays, as presented in the audited FY 2006 Statement of Budgetary Resources, will be reconciled to the amounts included in the Budget of the United States Government when they become available. The Budget of the United States Government with actual numbers for FY 2006 has not yet been published. We expect it will be published by March 2007, and it will be available on the OMB website at <http://www.whitehouse.gov/omb/budget/fy2008>. The actual amounts published for the year ended September 30, 2005 are included in EPA's FY 2006 financial statement disclosures.

FY 2005	Budgetary Resources	Obligations	Offsetting Receipts	Outlays
Statement of Budgetary Resources	\$ 2,475,250	1,544,858	\$ 64,964	\$ 1,258,692
Funds Reported by Other Federal Entities	19,285	4,576		5,329
Adjustments to Outlays				5,105
Less: 1993 Superfund Cost Recovery	(1,970)		(1,970)	
Expired and Immaterial Funds*	(4)	(23)		
Rounding Differences**	(561)	589	(16)	(126)
Reported in Budget of the U. S. Government	\$ 2,492,000	\$ 1,550,000	\$ 62,978	\$ 1,269,000

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

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

Note S7. Superfund Eliminations

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

	<u>FY 2006</u>	<u>FY 2005</u>
Advances	\$7,843	\$ 9,256
Expenditure Transfers Payable	\$37,227	\$48,903
Accrued Liabilities	\$4,642	\$ 6,398
Expenses	\$25,491	\$29,674
Transfers	\$43,493	\$49,097

Note S8. Other, Statement of Financing

The “Other” balance on the Statement of Financing of \$1.8 million for FY 2006 and \$1.9 million for FY 2005 represent a portion of the 1993 Cost Recovery received from the Uniroyal bankruptcy judgment that was transferred from the Treasury Managed Receipt Account 20X8145.4 to the Superfund Trust Account 68-20X8145. The transfer was necessary in order to execute expenditures from consent decrees.

2.
Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Improper Payments Information Act of 2002 (IPIA) Report
For the Year Ended September 30, 2006

I. RISK ASSESSMENTS: After reviewing and sampling disbursements made in the highest risk susceptible inventories, EPA determined that its programs do not have “significant erroneous payments,” defined by the IPIA as payments exceeding \$10 million and 2.5% of program payments. Because the Clean Water and the Drinking Water State Revolving Funds (SRFs) are former Section 57 programs, EPA is required to submit an IPIA corrective action plan for them. The Agency’s corrective action proposed to reduce the error rate of improper payments in the SRFs from 0.51 percent to 0.30 percent over a five-year period. By the end of FY 2005, EPA surpassed the FY 2008 target of 0.30 percent. The error rates for these two programs were as follows:

Program: Clean Water and Drinking Water SRFs

Fiscal Year	Outlays	Erroneous Payments	Error Rate
2004	\$2.1 billion	\$10.3 million	0.47 percent
2005	\$2.3 billion	\$3.0 million	0.13 percent
2006	\$2.0 billion (est.)	\$3.5 million	0.18 percent

II. STATISTICAL SAMPLING PROCESS: Based on the FY 2006 Measurement Plan approved by OMB, EPA pulled a statistical sample of 252 direct payments from a population of 5,800 direct grant payments (126 transactions for each SRF). The error rate for the direct payment sample was 0.0 percent. Additionally, the Agency reviewed a statistical sample of subrecipient transactions for each SRF in South Carolina and New Hampshire. Results for South Carolina indicated erroneous payments of \$683 thousand from a universe of \$56 million payments (an error rate of 1.2 percent). Erroneous payments in New Hampshire totaled \$47 thousand from a universe of \$31 million payments (an error rate of 0.15%). In FY 2006, EPA also reviewed the Texas Single Audit Act audit report. The auditors did not find any improper payment issues. In addition, the Agency reviewed a judgmental sample of over 200 transactions for each SRF program during State reviews. These reviews identified \$2.8 million of erroneous payments from a universe of over \$875 million payments.

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

A. Grants: As described in Section II above, EPA continued reviewing direct and subrecipient SRF payments. In FY 2005, the Agency identified modifications needed to enable tracking erroneous payments by grant recipient in the Grantee Compliance Database. These modifications were implemented in FY 2006.

During FY 2005, EPA performed an erroneous payments review for calendar year (CY) 2004 using judgmental risk-based sampling to select 267 grant recipients for administrative reviews including 111 non-profit grantees. Nineteen of the non-profit grantee reviews identified potential erroneous payments. In FY 2006, the Agency completed its risk-based judgmental sample of CY 2005 99 non-profit recipient reports to determine erroneous payments. Of the 99 reviews, 24 identified potential erroneous payments. Results of both years are provided in the table below. EPA will report updated information on the appeal process results (no final determination/may not to be erroneous) in the FY 2007 PAR. The Agency also reports on these results for the Improved Financial Management Initiative of the President's Management Agenda.

Non-Profit Grantees Review/Audit Results	CY 2004 Review	CY 2005 Review
All potential erroneous payments cited	\$650,799	\$1,016,967
Questioned costs determined allowable	\$224,977	\$217,418
Actual erroneous payments (unallowable costs)	\$18,755	\$14,298
Costs that have been recovered	\$18,755	\$14,298
Costs still in recipient appeal process	\$421,260	\$785,251
Percent of erroneous payments	0.21 percent	0.07 percent

Additionally in FY 2006, EPA introduced a new statistical sampling approach for the review of CY 2006 non-profit grantee monitoring/audit reports for erroneous payments

B. Contracts: EPA continues to take appropriate action as needed to reduce or eliminate improper payments. The appropriate Contracts Officer Representatives or On Scene Coordinators are notified of all improper payments discovered. In January 2003, EPA implemented a monthly Improper Contracts Payment Report. The report captures the number of improper payments per month and provides information on each improper payment including the reason and recovery status. In FY 2006, the Agency received final Recovery Audit Report – the audit reviewed 376,000 small purchase and contract payment transactions worth \$6.5 billion. The Audit Recovery contractor reviewed 100,471 contract payments totaling \$4.3 million and found only 4 erroneous payments (a 0.01 percent error rate). EPA has addressed all audit recommendations cited in the Recovery Audit Report.

Results of EPA's Improper Contract Payments Report

Fiscal Year	Number of Erroneous Payments	Erroneous Payments (Dollars in Thousands)	Error Rate for Dollars
2003 *	25 (of 24,056)	\$206.1	0.02 percent
2004	21 (of 24,886)	\$748.5	0.08 percent
2005	21 (of 26,305)	\$121.5	0.01 percent
2006	25 (of 28,098)	\$406.5	0.03 percent

- * FY 2003 only included data from January through September.
- For all four years, all erroneous payments were fully recovered.

Based on EPA’s excellent performance and effective controls, the Agency does not plan future externally conducted recovery audits – a formal Recovery Audit is not cost effective for the contractor who is paid based on erroneous payments found/recovered. The Agency will continue using the monthly Improper Contracts Payment Report as the tool for monitoring contract payments.

C. Commodity Payments: Since no high risk areas have been identified, no corrective action is required. EPA continues to take appropriate action as needed to reduce or eliminate any improper payments. The commodity payments were included in the Recovery Audit described above in Section III. B. Contracts. The Recovery Audit contractor reviewed 275,185 invoices paid totaling \$2.2 million and found 31 improper payments (less than 0.01 percent error rate). The improper commodity payments were attributed to product returns not deducted, duplicate payments due to keypunch errors and vendor number errors, cash discounts not taken, and state and local tax exemptions not taken. As of January 2006, the Agency consolidated its commodity payments operation to one Finance Center. The consolidation achieves a higher degree of internal control, consistency and oversight. The consolidation plus several other corrective actions address the Recovery Audit Report recommendations. In preparation for replacing the core financial system, EPA is completing a review of the vendor file to ensure the accuracy of all vendor codes.

The Agency implemented a commodities payment tracking mechanism in January 2004 to gather improper payment data. This tracking system provides the data for a monthly Improper Commodity Payment Report which includes information on each improper payment. Given the low rate of erroneous payments, EPA does not plan future externally conducted recovery audits – a formal Recovery Audit is not cost effective for the contractor who is paid based on erroneous payments found/recovered. The Agency will continue using the monthly Improper Commodity Payment Report as the tool for monitoring these payments.

Results of EPA’s Improper Commodity Payments Report

Fiscal Year	Number of Erroneous Payments	Erroneous Payments (Dollars in Thousands)	Error Rate for Dollars
2005	40 (of 42,698)	\$416.0	0.17 percent
2006	102 (of 50,665)	\$695.5	0.23 percent

D. Payroll: By December 31, 2004, the Payroll Workgroup completed a comprehensive review of internal controls and submitted recommendations to reduce improper payments. Additionally, in FY 2005, the workgroup developed a corrective action plan/best practices. EPA implemented these corrective actions before the Agency transferred the payroll disbursement function to the Department of Defense. EPA now benefits from the combination of both agencies’ internal controls.

E. Travel Card/Purchase Card: The Agency continues to monitor the travel and purchase charge card transactions in accordance with the Agency policies and procedures. In

addition, EPA monitors the issuance of purchase cards to ensure that spending limits and span of control are kept to a minimum. The Agency implemented a monitoring program that requires each of the Senior Resource Officials to perform yearly reviews of the purchases made within their program offices. These reviews ensure the integrity of the purchase card program. During FY 2006, EPA implemented a Katrina Stewardship plan which added the following controls:

- Notify card holder’s approving official via email for each purchase – daily;
- Conduct reviews within 60 days of transactions; and
- Review Agency Atypical Report which identifies airline ticket purchase without authorizations.

IV. IMPROPER PAYMENT (IP) REDUCTION OUTLOOK FY 2004 – FY 2007
(Dollars in millions)

Program	FY 2004 Outlays	FY 2004 IP %	FY 2004 IP \$	FY 2005 Outlays	FY 2005 IP %	FY 2005 IP \$	FY 2006 Outlays	FY 2006 IP %	FY 2006 IP \$	FY 2007 Outlays	FY 2007 IP %	FY 2007 IP \$	FY 2008 Outlays	FY 2008 IP %	FY 2008 IP \$
Clean Water and Drinking Water SRFs	\$2,182 (actual)	0.47	\$10.3	\$2,302 (actual)	0.45 target 0.13 actual	\$3.0	\$1,963 (est.)	0.40 target 0.18 actual	\$3.5	\$1,543 (est.)	0.35	\$5.4 (est.)	\$1,565 (est.)	0.30	\$4.7 (est.)

V. RECOVERY AUDIT PROGRAMS: The Agency hired a contractor, Business Strategy, Inc (BSI), to conduct the recovery audit. BSI provided their final report and recommendations in FY 2006. As reported above in the Contracts and Commodities sections, BSI did not uncover any material transactions that were erroneously paid.

During FY 2006, EPA implemented cost effective corrective actions to address BSI recommendations. These actions strengthened payment processes and internal controls to help prevent further occurrences.

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

VII. INFORMATION SYSTEMS AND INFRASTRUCTURE: The Agency’s information systems are sufficient to reduce improper payments to targeted levels.

VIII. STATUTORY AND REGULATORY BARRIERS: None.

IX. CONCLUSIONS: EPA met all of the requirements and received a Green Status on Eliminating Improper Payments as of June 30, 2006. The Agency has demonstrated a low level of risk for the SRF programs through statistical sampling of direct payments, targeted state reviews, statistical sampling of subrecipient payments in two states, and analysis of subrecipient payments in Texas Single Audit Act report. Based on the guidelines contained in Appendix C to OMB Circular A-123, Part I, Section K, EPA requested relief from the annual reporting requirements of the Improper Payment Information Act for the Clean Water and Drinking Water SRFs. Section K permits agencies to request relief from IPIA reporting requirements if a program has documented a minimum of two consecutive years of improper payments that are less than \$10 million annually. EPA met this requirement for fiscal years 2005 and 2006 for the SRF programs. On October 5, 2006, OMB granted the Agency's request to waive statistical testing of SRF transactions for fiscal years 2007-2009. EPA will be required to resume statistical assessment and report on the SRF programs in the FY 2010 PAR. OMB's approval to begin reporting every third year is contingent on no significant legislative or programmatic changes, significant funding increases and/or any change that would result in substantial program impact. If such changes occur, the Agency must reinitiate risk assessments and comply with IPIA reporting requirements if there is significant risk of improper payments occurring.

For FY 2007, EPA committed to the following activities:

- Report on improper payments in the PAR;
- Continue to monitor commercial payments to ensure accuracy and characterize monitoring efforts annually in the PAR; and
- Brief OMB, as needed, depending on program changes, legislative and/or funding revision, or anything that development from EPA's monitoring.

Agency's Response to Draft Report



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

OFFICE OF
CHIEF FINANCIAL OFFICER

November 13, 2006

MEMORANDUM

SUBJECT: Draft Audit Report: Response to Audit of EPA's Fiscal Years 2006 and 2005 Financial Statements

FROM: Lyons Gray /s/
Chief Financial Officer

TO: Bill Roderick
Acting Inspector General

My staff and I thank you for the opportunity to respond to the Draft Audit Report of the U. S. Environmental Protection Agency's Fiscal Years 2006 and 2005 Financial Statements. We agree with the issues raised and have some observations and clarifications to offer. These are provided in the attachment.

We believe our existing controls, policies and procedures are effective. We are in the final stages of consolidating several financial functions that will improve our efficiency and effectiveness and have already assisted in streamlining the audit process. As with anything new, challenges exist, but we are currently evaluating ways to improve operations without compromising fiscal integrity.

This year was a model year for both of us. We worked closely implementing some of the best practices in Government, which resulted in a smoother audit process. We thank you for your commitment and diligence.

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

Attachment

cc: Melissa Heist
Paul Curtis
Maryann Froehlich
Joshua Baylson
Lorna M. McAllister
Iantha Gilmore
Milton Brown
Raffael Stein

OCFO's Response to the FY 2006 and FY 2005 Draft Audit Report

Introduction

We offer the following observations and clarifications:

- The transfer of receivables to the Finance Centers started in FY 2004 and continued into FY 2006. EPA was consolidating processes for efficiency, consistency, and improved internal controls. The consolidation did not cause changes in accounting processes or internal controls.
- As part of the transition, we concede that transferring the receivables from the regions to Cincinnati could have been executed more effectively.
- Consolidating accounting functions and reclassifying debt over two years old consistent with OMB Circular A-129 and Treasury guidance during FY 2006 contributed to the unanticipated abnormal account balances including the year-end bad debt expense account.
- Each quarter EPA works to reconcile differences reported by the Department of Treasury with our major trading partners. As a result of our preliminary review of the 4th quarter Treasury Intragovernmental Activity Report, OCFO identified potential adjustments that will reduce the total unreconciled difference from \$518 million to \$231 million.

Reportable Conditions

1. EPA's Implementation of Accounting Processes Resulted in Misstatements

OIG Recommendation 1: We recommend the OCFO require the Reporting and Analysis Staff: Make the necessary corrections to properly adjust fiscal 2006 bad debt expense, revenue and advance accounts to their normal balances.

OCFO Response: OCFO agrees. OCFO's review determined that only the bad debt expense account required an adjustment. This adjustment was made for financial statement purposes and will be posted in the accounting system in FY 2007.

OIG Recommendation 2: We recommend the OCFO require the Reporting and Analysis Staff: Work with finance offices to correct the impact of any future Currently Not Collectible (CNC) reductions against entries originally recorded in the first through third quarters of fiscal 2006.

OCFO Response: OCFO believes that the recommendation should be modified to end after the word "reductions." An analysis was completed on all fiscal 2006 CNC activity. For fiscal year 2007, the accounting model will be re-evaluated and the impact will be monitored.

OIG Recommendation 3: We recommend the OCFO have the Financial Management Offices and Finance Centers: Continually monitor CNC decrease entries to transactions originally recorded in the first through third quarters of fiscal 2006 for abnormal increases in the allowance accounts and decreases in revenue.

OCFO Response: OCFO believes that the recommendation should delete the words "continually" and "originally recorded the first through third quarters of fiscal 2006." OCFO will formally monitor these transactions monthly instead of quarterly.

OIG Recommendation 4: We recommend the OCFO have the Financial Management Offices and Finance Centers: Notify Reporting and Analysis Staff of these CNC decrease entries and any allowance for doubtful account decrease entries needed to correct allowance accounts.

OCFO Response: OCFO will revise the appropriate accounting models and amend the CNC policy.

2. EPA Misclassified Interagency Agreement Advances to Other Federal Agencies

OIG Recommendation 5: We recommend the OCFO have the CFC: Ensure all future payments under advanced funded disbursement IAGs are recorded as advances and expenses are recognized in the period incurred.

OCFO Response: OCFO will coordinate efforts with the Office of Grants and Debarment to strengthen procedures when entering into advance agreements with other federal entities. Such agreements will establish terms and conditions within the IAG process, so that both entities will be able to compile complete, accurate and timely financial information for reporting and recognizing revenue and expenses in the proper period.

OIG Recommendation 6: We recommend the OCFO: Establish written procedures for recovering advances from other agencies when those agencies fail to provide proper and timely supporting documentation of the funds being used.

OCFO Response: OCFO has written policy and procedures in place governing intragovernmental transactions with trading partners. These policies and procedures will be refined after issuance of OMB business rules (expected by early calendar year 2007) with stringent requirements governing the accounting for intragovernmental transactions including the appropriate handling of advances and other accounting transactions. In addition, OCFO volunteered to participate on the government-wide committee designed to resolve trading partner issues among agencies.

Compliance with Laws and Regulations

3. EPA Did Not Reconcile Differences with Trading Partners

OIG Recommendation 7: We recommend the OCFO: Require the Office of Financial Management to reconcile the Agency's intragovernmental transactions to comply with Federal financial reporting requirements.

OCFO Response: OCFO agrees with the recommendation and will continue to make progress in this area. The Office of Financial Services will work with the appropriate EPA offices and other federal agencies to obtain the necessary documentation to support these transactions.

Report Distribution List

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