Inspector General's Report on EPA's Fiscal 2005 and 2004 Consolidated Financial Statements

Contents

U.S. Environmental Protection Agency
Office of Inspector General

2006-1-00015
November 14, 2005

At a Glance

Catalyst for Improving the Environment

Why We Did This Audit

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

- EPA's 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/2006/20051114-2006-1-00015.pdf

Audit of EPA's Fiscal 2005 and 2004 Consolidated Financial Statements

EPA RECEIVES UNQUALIFIED OPINION

We rendered an unqualified, or clean, opinion on EPA's Consolidated Financial Statements for fiscal 2005 and 2004, meaning that they were fairly presented and free of material misstatement.

INTERNAL CONTROL REPORTABLE CONDITIONS NOTED

EPA converted to a new payroll system in fiscal 2005. While EPA was able to resolve many issues arising from the conversion, we noted several reportable conditions. Most significantly, EPA made inappropriate payments to separated (transferred, retired, or resigned) employees and made excess salary payments to current employees. These conditions occurred because EPA's automated controls and manual processes were not effective in identifying and preventing these overpayments, or alerting EPA officials to take corrective actions in a timely manner.

In addition to these conditions, we noted seven other reportable conditions including overstated State Superfund Contract unearned revenue and unbilled Superfund oversight costs, improperly adjusted general ledger accounts, inadequate documentation for adjustments made to entries in EPA's Integrated Financial Management System (IFMS), and uncorrected data that IFMS rejected.

NONCOMPLIANCE WITH LAWS AND REGULATIONS NOTED

The Agency still is in noncompliance with laws and regulations relating to implementing the cost accounting standard and reconciling intragovernmental transactions, though we do not consider EPA to be in substantial noncompliance.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL EVALUATION

In a memorandum received on November 10, 2005, from the Chief Financial Officer, the Agency agreed with the issues raised and stated it has begun to evaluate the best methods to address each issue to achieve a timely resolution.

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

November 14, 2005

OFFICE OF
INSPECTOR GENERAL

MEMORANDUM

SUBJECT: Audit of EPA's Fiscal 2005 and 2004 Consolidated Financial Statements
Report No. 2006-1-00015

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

TO: Lyons Gray
Chief Financial Officer (2710A)

CC: Luis A. Luna
Assistant Administrator for Administration and Resources Management (3101A)

Attached is our audit report on the Agency's fiscal 2005 and 2004 consolidated financial statements. Management is presenting the financial statements for fiscal 2005 and 2004 in a consolidated format which is a change from prior years' presentations where the Superfund Trust Fund was presented separately. The Agency continues to make improvements in cost accounting; however, it is still not in full compliance with the managerial cost accounting standard. In our view, the level of compliance does not meet the Office of Management and Budget's definition of substantial noncompliance. The audit report also contains other findings that describe issues the Office of Inspector General (OIG) has identified and corrective actions the OIG recommends.

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

In accordance with EPA Manual 2750, *Audit Management Process*, the primary action official is required to provide us with a written response to the final audit report within 90 days of the final audit report date. Since this report deals primarily with financial management issues, we are requesting the Chief Financial Officer, as the primary action official, to take the lead in coordinating and providing us a written response to this report. The response should address all issues and recommendations contained in Attachments 1 and 2. For corrective actions planned but not completed by the response date, reference to specific milestone dates will assist us in deciding whether or not to close this report in our audit tracking system.

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

Attachment

cc: See Appendix III, Report Distribution List

Inspector General's Report on EPA's Fiscal 2005 and 2004 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, 2005 and 2004, 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 01-02, *Audit Requirements for Federal Financial Statements*. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The financial statements include expenses of grantees, contractors, and other Federal agencies. Our audit work pertaining to these expenses included testing only within EPA. Audits of grants, contracts, and interagency agreements performed at a later date may disclose questioned costs of an amount undeterminable at this time. 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, 2005 and 2004, 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 2005 and 2004, which are being presented for additional analysis and are not a required part of the basic financial statements. Management has elected to omit certain disclosures required by OMB Circular A-136, *Financial Reporting Requirements*, that accounting principles generally accepted in the United States have determined are necessary. 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. OMB Circular A-136, *Financial Reporting Requirements*, requires agencies to report, as Required Supplementary Information, their intra-governmental assets and liabilities by Federal trading partner. We found that EPA was able to reconcile its records with its trading partners, except for Health and Human Services (see Attachment 2 for additional details on this issue).

Evaluation of Internal Controls

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

- **Reliability of financial reporting:** Transactions are properly recorded, processed, and summarized to permit the timely and reliable preparation of the financial statements and RSSI in accordance with generally accepted accounting principles; and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- **Reliability of performance reporting:** Transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.
- **Compliance with applicable laws and regulations:** Transactions are executed in accordance with laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements or RSSI; and any other laws, regulations, and government-wide policies identified by OMB.

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

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

In addition, we considered EPA's internal control over the RSSI by obtaining an understanding of the

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

Finally, with respect to internal controls related to performance measures presented in *EPA's Fiscal Year 2005 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. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not express an opinion on such controls.

REPORTABLE CONDITIONS

Reportable conditions are internal control 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 nine reportable conditions, as follows:

Payroll Internal Controls

EPA inappropriately made payroll payments to separated (transferred, retired, or resigned) employees. EPA's controls over processing time and attendance records for separated employees were not effective in identifying and preventing overpayments because automated controls were not implemented and manual controls were not followed. In particular, PeoplePlus' automated controls do not allow timekeepers to halt all future payments or limit the number of default payroll payments to separated employees with a single transaction. Manual processes, such as processing personnel action requests and reviewing exception reports, did not effectively alert EPA officials to take corrective actions in a timely manner. As a result of the identified weaknesses, EPA made approximately $74,000 in payroll payments to separated employees for which the Agency must attempt to recover the funds.

Excess Salary Payments

EPA employees received salary payments in excess of the biweekly maximum earnings limitations prescribed in Federal regulations. Under 5 CFR §550.105, an employee may receive premium pay only to the extent that the payment does not cause the total of his or her basic pay and premium pay for any biweekly pay period to exceed the greater of: the maximum biweekly rate of basic pay for a GS-15 (including any applicable locality-based comparability payment under section 5304 or similar provision of law and any applicable special rate of pay under 5 U.S.C. 5305 or similar provision of law), or the biweekly rate payable for Level V of the Executive Schedule.

State Superfund Contract and Superfund Unbilled Oversight Accruals

We found errors on the third quarter State Superfund Contract calculation spreadsheet and/or the Superfund unbilled oversight spreadsheet in 9 of 10 regions. These errors led to overstating State Superfund Contract unearned revenue by $31 million and unbilled oversight by $14 million. Although the Office of the Chief Financial Officer (OCFO) required the regions to certify that they reviewed their accrual calculations, the certification process did not prevent or discover the errors. As a result, EPA could not ensure the accuracy of the unearned revenue and the unbilled oversight accounts.

General Ledger Account Adjustments for Receivables Transferred to Cincinnati Finance Center

EPA's general ledger accounts for accounts receivable and allowance for doubtful accounts were materially misstated because certain regional offices did not properly adjust those accounts when transferring receivables to the Cincinnati Finance Center.

Quality Assurance Reviews

While EPA made several advances to improve the financial management quality assurance (QA) program performed by the regions and finance centers, problems continue in its Quality Assurance Reviews (QARs). We found the QARs performed were limited in scope and less comprehensive than the QA Guide suggests. We also found that the reviews did not adequately document the work performed or other methods used to evaluate internal controls and accounting events. Further, we found that QARs were not performed for all applicable accounting events. As a result, there is limited assurance that the QARs provide a sufficient basis to evaluate and certify the assessment of internal accounting and administrative controls.

Distribution of Budget Clearing Accounts

The fiscal 2005 year-end distribution of amounts recorded in a budget clearing account was overstated. The Agency treated charge backs on collections on certain Interagency Agreements as if they were distributions rather than reductions in receipts.

Documentation of Adjustments to IFMS Entries

EPA made adjustments to entries in the Integrated Financial Management System (IFMS), the Agency's accounting system, without proper and adequate documentation. During our review of collections and receivables recorded in various EPA regions, we found 33 adjustments to entries in IFMS—totaling $89,446,286—that were not supported by sufficient documentation, such as schedules of collections or IFMS screen prints. The documentation did not always identify other relevant documents, such as the consent decree, which was the basis for the adjustment. We also found three adjustments—totaling $47,540,900—where documentation supporting the change was not easily accessible. EPA staff had documentation to support the adjustment, but did not attach it to the entry or otherwise provide an audit trail to locate the support. These entries also did not contain evidence of an adequate review to ensure the adjustments were reasonable and supported.

Correcting Rejected Transactions

The OCFO did not correct PeoplePlus data that the IFMS rejected during the transfer process in a timely manner. We identified nonprocessed transactions in a suspense file that existed for several pay periods without management action. Federal requirements stipulate that agencies promptly record, classify, and account for transactions to prepare timely accounts and reliable financial reports. Without having the processes in place to reconcile and correct data that failed to transfer from PeoplePlus to IFMS, the financial statements could be misstated.

Contingency Plans for Financial Applications

A review conducted by a contracted public accounting firm noted that contingency plans did not fully comply with EPA or Federal guidelines for several OCFO applications at the Research Triangle Park campus in North Carolina. The firm identified where EPA had not documented: (1) key contingency plan elements, (2) critical hardware and software requirements, and (3) primary and secondary contacts. These weaknesses occurred because of inconsistency in training for relevant contingency planning officials. Incomplete contingency plans could present significant challenges for EPA should an unforeseen event occur, particularly since the organization may believe these systems have sufficiently documented procedures to expedite recovery. Further, without adequate planning, management may not be able to mitigate the negative effects of interrupted operations and determine how long specific operations may be suspended or postponed.

Attachment 1 describes each of the above reportable conditions in more detail, and contains our recommendations on actions that should be taken to correct these conditions. We have 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. 01-02, *Audit Requirements for Federal Financial Statements*, requires us to compare material weaknesses disclosed during the audit with those material weaknesses reported in the Agency's Federal Managers' Financial Integrity Act (FMFIA, or Integrity Act) report that relate to the financial statements and identify material weaknesses disclosed by audit that were not reported in the Agency's FMFIA report.

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 2005.

Tests of Compliance with Laws and Regulations

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

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. 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 reported that the approximately 9,000 confidential financial disclosure forms filed by EPA employees by November 1, 2005, will be reviewed by the deputy ethics officials no later than January 23, 2006. Since the Agency has not had time to review such reports and disclose matters that would require further inquiry, resolution, or reporting, we did not perform any tests or additional inquiries about those reports. Had the Agency been able to review the reports and we had been able to perform tests or make additional inquires, matters may have come to our attention that would require reporting.

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

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT NONCOMPLIANCE

Under FFMIA, we are required to report whether the Agency's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. OMB Bulletin No. 01-02, as supplemented by an OMB memorandum dated January 4, 2001, Revised Implementation Guidance for the Federal Financial Management Improvement Act, substantially changed the guidance for determining whether an Agency substantially complied with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. The document is intended to focus Agency and auditor activities on the essential requirements of FFMIA. The document lists the specific requirements of FFMIA, as well as factors to consider in reviewing systems and for determining substantial compliance with FFMIA. It also provides guidance to Agency heads for developing corrective action plans to bring an Agency into compliance with FFMIA. To meet the FFMIA requirement, we performed tests of compliance with FFMIA section 803(a) requirements and used the OMB guidance, revised on January 4, 2001, for determining substantial noncompliance with FFMIA.

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

As described in Attachment 3, OCFO has redefined it cost accounting outputs and made other improvements. However, during Fiscal Year 2005, the Agency was not in compliance with Statement of Federal Financial Accounting Standards No. 4 that requires EPA to provide full costs per output to management in a timely fashion. Subsequent to completing our audit work, the Agency developed a report to show full costs of its outputs; we will evaluate that report during Fiscal Year 2006.

We identified a FFMIA noncompliance related to reconciliation of intragovernmental transactions. However, this noncompliance does not meet the definition of substantial noncompliance as described in OMB guidance. Attachment 2 provides additional details, as well as recommendations on actions that should be taken on this matter.

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

Prior Audit Coverage

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

- Complying with FFMIA requirements.
- Reconciliation and reporting intragovernmental transactions, assets and liabilities by Federal trading partner.
- Complying with Statement of Federal Financial Accounting Standards No. 4, including accounting for the cost to achieve goals and identifying and allocating indirect costs.
- Interagency Agreement invoice approval process.
- Documenting EPA's IFMS.
- Complying with Federal financial management system security requirements.
- Preparation and reconciliation of Statements of Transactions.
- Documentation and approval of journal and standard vouchers.
- Reconciling Unearned Revenue for State Superfund Contracts.
- Managing Accounts Receivable.
- Recording of Marketable Securities.
- Accounting for Obligations.
- Accounting for Contractor-Held Property.
- Assessing automated application processing controls for IFMS.
- Security Screenings for Non-Federal Personnel.
- Change Control Procedures for IFMS.
- System Certification, Accreditation, and Development for Grant and Inter-Governmental Systems.
- Compliance of financial system security plans.

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

Agency Comments and OIG Evaluation

In a memorandum dated November 10, 2005, 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 Audit
Office of Inspector General
U.S. Environmental Protection Agency
November 9, 2005

Attachment 1: Reportable Conditions

1. EPA Should Improve Payroll Internal Controls

EPA inappropriately made payroll payments to separated (transferred, retired, or resigned) employees. Specifically, EPA's controls over processing time and attendance records for separated employees were not effective in identifying and preventing overpayments because automated controls were not implemented and manual controls were not followed. In particular, PeoplePlus' automated controls do not allow timekeepers to halt all future payments or limit the number of default payroll payments to separated employees with a single transaction. In addition, manual processes, such as processing personnel action requests (PAR) and reviewing exception reports, did not effectively alert EPA officials to take corrective actions in a timely manner. As a result of the identified weaknesses, EPA made approximately $74,000 in payroll payments to separated employees for which the Agency must attempt to recover the funds.

PEOPLEPLUS AUTOMATED CONTROLS NEED IMPROVEMENT

Automated controls in PeoplePlus do not allow timekeepers to stop all future payments to separated employees by entering the "DTNPY" code just one time. To prevent PeoplePlus from inappropriately paying separated employees, the system currently requires the timekeeper to re-enter this code every pay period until the human resources department processes the PAR, separating the employee from EPA. The DTNPY code is a time reporting code used for separated employees to tell the system not to pay them. We also found that timekeepers did not consistently enter the code into PeoplePlus each pay period, which contributed to several instances where employees received payroll payments although they separated from EPA.

This problem is compounded by the fact that EPA does not limit the number of payments it makes to separated employees. EPA's management chose to configure the PeoplePlus system to pay employees for working their standard hours (e.g., 80 hours for a full-time employee) by default, even if a timesheet was not submitted (entered and attested to by an employee, timekeeper, or manager) for multiple pay periods.

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As a result of these two issues, a separated employee could receive payroll payments after leaving EPA for every pay period that the timekeeper does not enter the time reporting code into PeoplePlus until the human resources department processes the PAR.

PROCESSING OF PERSONNEL ACTION REQUESTS NEEDS IMPROVEMENT

The time required to process PARs resulted in delays in deactivating separated employees' time and attendance records. The Office of Human Resources (OHR) developed procedures to process personnel actions for term appointments and transferred employees without a PAR and informal procedures to do the same for retiring employees. The procedures allow OHR to initiate the necessary transaction to deactivate separated employees' future time and attendance records. However, the procedures were not implemented across the Agency and not consistently followed where they were implemented. As a result, the manual preparation of the PAR by the EPA office and the OHR processing, in several cases, took from 1 to 3 months to complete. Furthermore, in almost all the cases where the Agency made overpayments to separated employees, the PAR was processed after the employee separated from EPA.

USE OF EXCEPTION REPORTS NEEDS IMPROVEMENT

EPA offices did not effectively use the PeoplePlus-generated "Missing Time & Attendance" report to identify employees without entered or certified and approved time and attendance records. EPA implemented this standard report in PeoplePlus to provide offices a tool to manage their employees' time and attendance records. However, offices did not run the reports in a timely manner nor take actions to prevent inappropriate payments. Therefore, in May 2005, the OCFO issued OFM Policy Announcement No. 05-05, *Responsibility of Supervisors to Approve Time and Attendance*, to compensate employees despite missing or unapproved biweekly time and attendance information.

Policy Announcement No. 05-05 states that "employees who fail to enter their time will be paid based upon their standard hours (default hours). Employees who have entered time that was not approved by his/her supervisor will be paid based upon the time reported (mass approval). When employees are paid based upon their default hours or the mass approval process, supervisors should ensure PeoplePlus corrections are made, and then indicate their approval by signing the Time Certification Reports. The Regional Comptroller/Program Management Officer certifies that the appropriate actions were taken by the supervisor and then sends, by fax, the appropriate signed report to the Washington Finance Center before the end of the following pay period.

We examined the Mass Approval Time and Attendance Reports and Default Hours Reports for the pay period ending July 9, 2005. We found that

- The Washington Finance Center used the mass approval process to complete the PeoplePlus pay calculation for 21 Headquarters and regional offices, but did not receive required mass approval certifications from 10 offices and an 11th submitted the certification late.
- For default hours, employees in 14 Headquarters and regional offices were paid based on their standard hours; however, the required default hours certifications were not received from 9 offices and 2 other offices submitted the certifications late.

We believe the failure of Agency managers to comply with Policy Announcement No. 05-05 is an internal control weakness that could contribute to Agency employees being improperly compensated.

Our review of Default Hours Reports identified other concerns. We found that

- Separated employees were listed on multiple Default Hours Reports.
- The OCFO also did not generate or provide Default Hours Reports for program offices for seven pay periods during fiscal 2005. Based on a preliminary review, Agency officials estimated that there were 72 instances (totaling approximately $74,000) where employees were paid after separation from EPA. This approximation is most likely understated because the Agency's preliminary review excluded seven pay periods from fiscal 2005.
- Offices certified Default Hours Reports that contained separated employees, but did not have the timekeeper correct each employee's time and attendance record to prevent payment or annotate on the report that the employee had left the Agency.

RECOMMENDATIONS

We recommend that the OCFO and the Office of Administration and Resources Management (OARM) work together to

1. Develop and implement a policy that would hold the supervisors and Regional Comptrollers/ Program Management Officers accountable for ensuring that all required procedures associated with the processing of payroll and personnel actions are properly followed in a timely manner.

We recommend that the OCFO have the Director, Office of Financial Services (OFS),

2. Modify PeoplePlus and associated procedures to enable timekeepers to enter the DTNPY code into PeoplePlus one time to stop the system from making any future payments to separated employees.
3. Develop and implement procedures to facilitate identifying separated employees and implement an automated control to limit the number of default payments to these employees.

4. Complete the analysis of default payments for all fiscal 2005 pay periods to determine the number of payroll payments to separated employees and take appropriate action to collect the overpayment.

We recommend that the OARM have the Director, OHR,

5. Reinforce the use of established standard operating procedures to process PARs for separated term appointments and transferred employees, and implement the process across the entire Agency.
6. Formalize and implement the standard operating procedures for processing PARs for retiring employees and implement the process across the entire Agency.
7. Reinforce with Agency Officials that they need to (1) forward written resignation notices to OHR immediately upon receipt, and (2) prepare and forward PARs in a timely manner to prevent overpayments.

Agency Comment and OIG Evaluation

The OCFO and OARM generally concurred with our findings and recommendations. The Agency indicated that it would continue to validate payroll system internal controls, enforce existing procedures, and take further corrective action as needed. However, the Agency's response did not address the need for an automated control. Based on the problems described above, the current procedures have not been effective in identifying and preventing inappropriate payments to separated employees. Therefore, we believe improvement is needed in this area and that the Agency should implement automated controls to limit the potential harm caused by a breakdown in the current manual procedures.

2. EPA Employees Received Excess Salary Payments

Because the internal controls for EPA's PeoplePlus system did not effectively identify and prevent excess salary payments, Agency employees received salary payments in excess of the biweekly maximum earnings limitations prescribed in Federal regulations. Under 5 CFR §550.105, an employee may receive premium pay only to the extent that the payment does not cause the total of his or her basic pay and premium pay for any biweekly pay period to exceed the greater of:

1. The maximum biweekly rate of basic pay for a GS-15 (including any applicable locality-based comparability payment under section 5304 or similar provision of law and any applicable special rate of pay under 5 U.S.C. 5305 or similar provision of law); or
2. The biweekly rate payable for Level V of the Executive Schedule.

We examined individual employee gross salary payments for two pay periods. We found 37 employees received salary payments totaling $14,891 in excess of the biweekly maximum earning limitation for one pay period, and 24 employees received excess salary payments totaling $5,152 for the other pay period. The Agency has recently advised us that it has developed a manual process for checking for overpayments. However, due to the late receipt of this information, we have not been able to verify the process or its effectiveness.

Recommendations

We recommend that the OCFO

8. Develop and implement an automated control which would prevent employee salary payments in excess of maximum earnings limitations.
9. Verify that all overpayments have been researched for their cause and amount, and if due back to the Government, receivables established.

Agency Comment and OIG Evaluation

The OCFO agreed with the issues we raised and stated that it is initiating enhancements to broaden the scope of automated controls to replace existing manual controls. It plans to continue to evaluate the results as part of its payroll review process.

3. Improvement Needed for State Superfund Contract and Superfund Unbilled Oversight Accruals

EPA needs to improve its oversight of State Superfund Contract (SSC) and Superfund unbilled oversight accruals. We found errors on the third quarter SSC calculation spreadsheet and/or the unbilled oversight spreadsheet in 9 of 10 regions. These errors led to overstating SSC unearned revenue by $31 million and unbilled oversight by $14 million. Although the OCFO required the regions to certify that they reviewed their accrual calculations, the certification process did not prevent or discover the errors. As a result, EPA could not ensure the accuracy of the unearned revenue and the unbilled oversight accounts.

When EPA assumes the lead for a Superfund site remedial action in a State, the SSC clarifies EPA's and the State's responsibilities to complete the remedial action. EPA records a liability (unearned revenue) when billing a State for its share of the estimated site costs, and recognizes earned revenue when costs are incurred on the site. EPA incurs oversight costs while overseeing cleanup work being performed and paid for by potentially responsible parties at Superfund sites. EPA seeks to recover its oversight costs from the potentially responsible parties in a settlement agreement and recognizes revenue when it bills oversight costs. The unbilled oversight accrual is an asset established to properly match revenues and expenses.

EPA developed a review and certification process as a result of last year's position paper entitled "EPA Needs to Further Improve State Superfund Contracts' Unearned Revenue and Superfund Unbilled Oversight Cost Accruals." However, the number of errors found during the cumulative third quarter spreadsheets indicates that EPA's oversight of the accruals was not effective. For SSC unearned revenue, we found errors in cumulative disbursements, cumulative billings, and formula changes in the SSC calculation. For the unbilled oversight accruals, in addition to missing formulas, we found errors in formulas, cost amounts, billing percentages, and untimely accrual entries. EPA could have detected these errors with an effective review process. EPA needs to reassess its oversight and develop further instruction for preparing and reviewing these accrual calculations.

RECOMMENDATIONS

We recommended that the OCFO have the Director, OFM,

10. Provide more complete instructions and clarification to the regional offices to ensure the regions have an adequate preparation and review process.
11. Supplement the regional review process for SSC and Unbilled Oversight accruals with a centralized review function.

AGENCY RESPONSE AND OIG EVALUATION

OCFO agreed with the OIG recommendations. OCFO stated that it made considerable progress towards assuring consistency with the SSC and Superfund unbilled oversight accrual issues. OCFO stated it will explore options for centralizing these accrual processes.

4. Regions Should Make General Ledger Account Adjustments for Receivables Transferred to Cincinnati Finance Center

EPA's general ledger accounts for accounts receivable and allowance for doubtful accounts were materially misstated because certain regional offices did not properly adjust those accounts when transferring receivables to the Cincinnati Finance Center (CFC).

The Agency is in the process of consolidating financial operations into four finance centers. As part of this process, 5 of 10 regions had transferred accounts receivables to CFC by September 30, 2005. During our review of CFC's allowance for doubtful accounts, we noted that a Region had an allowance for doubtful accounts balance of $130,763,195 even though it did not have a receivables balance. Another Region had erroneously reduced its receivable balance in excess of the balance available, resulting in a negative balance of $2,914,484. Because of the transfers to CFC, the accounts receivable and allowance balances at those accounting points should have been adjusted to reflect a $0 balance.

These errors resulted because the regional accounts receivable staff did not properly review the general ledger account balances or perform analytical reviews that would have exposed the discrepancies. We did note that the agency has made the appropriate adjustments to the financial statements to adjust the allowance for doubtful accounts.

The Government Accountability Office's (GAO) *Standards for Internal Controls in the Federal Government*, dated November 1999, identified "control activities" as one of the five standards of internal control. According to GAO, management reviews (analytical reviews) at the functional or activity level are commonly performed internal control activities.

GAO's *Internal Control Management and Evaluation Tool*, dated August 2001, identified the following analytical reviews as common control activities: 1) managers at all activity levels review performance reports, analyze trends, and measure results against targets, and 2) both financial and program managers review and compare financial, budgetary, and operational performance to planned or expected results.

RECOMMENDATIONS

We recommended that the OCFO have the Director, OFM,

12. Require quarterly general ledger analytical reviews for finance centers and/or accounting points with receivable balances or activity.
13. Ensure appropriate adjustments are made to general ledger account balances when regional activity is transferred to finance centers.

AGENCY COMMENTS AND OIG EVALUATION

The Agency agreed with the audit issues raised. The Agency stated it successfully transferred 5 of 10 regions' accounts receivable functions to one finance center. An account analysis identified several accounting point balances that required adjustments that were subsequently reflected in the financial statements. As the Agency progresses in moving the accounts receivable functions from the remaining five regions, OCFO agreed to continue to monitor appropriate general ledger accounts.

5. EPA's Quality Assurance Reviews Need Further Improvement

While EPA made several advances to improve the financial management QA program performed by the regions and finance centers, the Agency must continue to improve its QARs. The OCFO updated the QA Guide in September 2005, increased oversight of the QA program, and provided Federal Managers' Financial Integrity Act training to appropriate personnel. However, we found the QARs performed were limited in scope and less comprehensive than the QA Guide suggests. We also found that the reviews did not adequately document the work performed or other methods used to evaluate internal controls and accounting events. Further, we found that QARs were not performed for all applicable accounting events. As a result, there is limited assurance that the QARs provide a sufficient basis to evaluate and certify the assessment of internal accounting and administrative controls.

EPA's quality assurance program was designed to implement the requirements of the *Federal Managers' Financial Integrity Act of 1982* and OMB Circular No. A-123, *Management Accountability and Control*. EPA's revised QA Guide describes a structured approach to conduct quality assurance reviews and provides a model framework for evaluating and reporting on finance office compliance with internal control standards and relevant accounting principles and standards. In addition, the OCFO's Fiscal Year 2005 Quality Assurance Workplan guidance recommends the regions and finance centers ensure that the QARs test the accounting events as appropriate, and document the rationale for any accounting events not tested.

During our analysis, we found QARs performed in fiscal 2005 that were more limited in scope than what was indicated in the QA Guide. The QA Guide provides specific control objectives and test procedures for each accounting event. For example, for accounts receivable, the QA Guide identifies 8 control objectives and 19 test procedures to evaluate internal controls. However, one accounts receivable QAR addressed only one control objective and test procedure. In another QAR, for property, only 1 control objective and test procedure were addressed, while the QA guide identified 10 objectives and 21 test procedures.

In addition, the QAR work was not adequately documented. The QA Guide states that workpapers should provide written evidence of the work performed, support the validity of conclusions reached, and provide a record of the methodology used. The QAR workpapers we reviewed did not document objectives of the review, the nature and extent of work performed, conclusions reached, and appropriate cross-references to other workpapers. We also noticed that the QAR workpapers we reviewed did not document other methods used to evaluate internal controls and accounting events, such as monthly travel audits.

We found that a regional office performed QARs for only 7 of the 13 applicable accounting events during the last 3 years. The QA Guide requires QARs to be performed for all applicable accounting events at least once every 3 years.

RECOMMENDATIONS

We recommend that the OCFO have the Director, OFM, to continue to improve the QA program by requiring field locations to

14. Perform more comprehensive QARs that define and address all the control objectives for applicable accounting events.
15. Adequately document the work performed and methods used to evaluate internal controls.
16. Perform a QAR for each applicable accounting event at least once every 3 years.

AGENCY COMMENTS AND OIG EVALUATION

The Agency agreed with the audit issues raised. OCFO believes it has made significant progress with the QA program and will conduct a training class in December 2005 for Agency finance personnel.

6. EPA Could Improve the Distribution of the Budget Clearing Accounts

The fiscal 2005 year-end distribution of amounts recorded in a budget clearing account was overstated. The Agency treated charge backs on collections on certain Interagency Agreements as if they were distributions rather than reductions in receipts.

The Cincinnati Finance Center records all Intra-Governmental Payment and Collection (IPAC) transactions in a budget clearing account pending interagency agreement Project Officer approval/disapproval. Once approved, the payment is removed from the clearing account and recorded in the appropriate account. EPA is required by the U.S. Treasury to reconcile and distribute budget clearing accounts by the end of the fiscal year. EPA has also adopted procedures to allocate costs. EPA's Year End Closing Instructions state "the amounts being recorded, at the end of the fiscal year need to be prorated among applicable appropriations in order to provide a more realistic distribution of charges via IPAC."

At year end, the Cincinnati Finance Center distributed $37,608,039 from the clearing account to expenditure accounts in various U.S. Treasury funds. Included in the distribution was $15,334,554 that should have been recorded as cash receipts, but was processed through IPAC as expenditures. As a result, the amounts recorded in expenditure and receivable accounts were overstated, and the amount recorded in the cash receipt account was understated by $15,334,554.

RECOMMENDATIONS

We recommend the OCFO have the Cincinnati Finance Center

17. Remove any receipt transactions from the year end distribution of the clearing account.

We recommend the OCFO have OFM's Reporting and Analysis Staff

18. Record an on-top adjustment to the financial statements to correct the $15,334,554 error and properly reflect expenditure, receivable, and receipt activity.

AGENCY COMMENTS AND OIG EVALUATION

The Agency agreed with the audit issues raised and made the appropriate accounting adjustments to the financial statements.

7. Documentation of Adjustments to IFMS Entries Needs Improvement

EPA made adjustments to entries in the IFMS, the Agency's accounting system, without proper and adequate documentation. During our review of collections and receivables recorded in various EPA regions, we found 33 adjustments to entries in IFMS—totaling $89,446,286—that were not supported by sufficient documentation, such as schedules of collections or IFMS screen prints. The documentation did not always identify other relevant documents, such as the consent decree, which was the basis for the adjustment. We also found three adjustments—totaling $47,540,900—where documentation supporting the change was not easily accessible. EPA staff had documentation to support the adjustment, but did not attach it to the entry or otherwise provide an audit trail to locate the support. These entries also did not contain evidence of an adequate review to ensure the adjustments were reasonable and supported.

EPA Comptroller Policy Announcement 93-02 requires "that all financial transactions recorded in the accounting system be supported by adequate source documentation, and that this documentation be easily accessible." These requirements apply to initial transactions entered into IFMS and to adjustments made to the entries. According to Policy Announcement 93-02:

> " 'Adequately documented' means an independent individual competent in accounting and possessing reasonable knowledge of EPA's operations should be able to examine the documentation and reach substantially the same conclusions as the persons who made and/or approved the entry."
>
> "'Easily accessible' means the entry should contain sufficient information to identify the supporting documentation, and the documentation should be organized and filed in a manner to facilitate its retrieval."

The GAO Standards for Internal Controls in the Federal Government state that "all transactions and other significant events are to be clearly documented, and the documentation is to be readily available for examination." The Standards also state "qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved."

Lack of adequate supporting documentation may raise questions about the validity and integrity of the financial information contained in IFMS. Failure to require adequate documentation before adjusting entries are input in the Agency's accounting system increases the risk of fraud, waste, and abuse by increasing the possibility that unauthorized or inaccurate information is entered.

RECOMMENDATIONS

We recommend that the OCFO

19. Require adequate documentation to support all adjustments to entries in IFMS. This documentation should include an adjustment date and justification for the correction, be easily accessible, and reference the original entry.

20. Require all adjustments to entries in IFMS be properly reviewed to ensure the policies are followed.

AGENCY COMMENTS AND OIG EVALUATION

The Agency agreed with the audit issues raised.

8. EPA Needs to Improve Correction of Rejected Transactions

The OCFO did not correct PeoplePlus data that the IFMS rejected during the transfer process. We identified nonprocessed transactions in a suspense file that existed for several pay periods without management action. This occurred because the OCFO had not corrected and cleared PeoplePlus transactions transferred to IFMS in a timely manner. Federal requirements stipulate that agencies promptly record, classify, and account for transactions to prepare timely accounts and reliable financial reports. Without having the processes in place to reconcile and correct data that failed to transfer from PeoplePlus to IFMS, the financial statements could be misstated.

EPA accumulates nonprocessed data in a suspense file during data transfer between the two systems. Our review determined that the OCFO had not timely corrected nonprocessed data for the following group of items in the suspense file:

Non-processed payroll transactions for 16 EPA employees remained in the suspense file because the employees did not have assigned Fixed Account Numbers in PeoplePlus. Our review indicated that some of the transactions go back as far as pay period 2, which ended October 16, 2004. The total of these transactions is $177,786 and the OCFO took no action to correct/reprocess the transactions.

RECOMMENDATION

We recommend that the OCFO have the Director, OFS,

21. Establish and implement policies and procedures to ensure the identification and timely processing of non-processed/rejected payroll transactions between PeoplePlus and IFMS.

AGENCY COMMENT AND OIG EVALUATION

The Director, OFS, concurred with our recommendation and indicated that the office took action to correct the payroll records for the 16 employees with missing Fixed Account Numbers.

9. EPA Needs to Improve Contingency Plans for Financial Applications

A review conducted by a contracted public accounting firm noted that contingency plans did not fully comply with EPA or Federal guidelines for several OCFO applications at the Research Triangle Park campus in North Carolina. The firm identified where EPA had not documented: (1) key contingency plan elements, (2) critical hardware and software requirements, and (3) primary and secondary contacts. These weaknesses occurred because of inconsistency in training for relevant contingency planning officials. Incomplete contingency plans can present significant challenges for EPA should an unforeseen event occur, particularly since the organization may believe these systems have sufficiently documented procedures to expedite recovery. Further, without adequate planning, management may not be able to mitigate the negative effects of interrupted operations.

The contracted public accounting firm's review identified the following specific contingency plan weaknesses:

- The Budget Automation System is not referenced in the OCFO's Office of Budget contingency plan. Agency officials did not fully document key contingency elements, such as an emergency telephone list and a listing of vendors, suppliers, and other service providers in the OCFO *Annual Planning and Budget Division Disaster Preparedness and Recovery Guide—Budget Automation System.*
- The PeoplePlus contingency plan does not identify the primary and secondary contacts, although the information is included in the Critical Applications Disaster Recovery Plan. Neither plan specifies which of the two plans takes priority should an outage occur.
- The firm noted inconsistency as to whether an application contingency plan was prepared for applications not subscribing to the National Computer Center Disaster Recovery Service. If a contingency plan was prepared, the level of detail within the plan was not consistent. For example, the Travel Manager +, Financial Data Warehouse, and Bank Card systems do not have separate contingency plans. Although the security plans for these systems address contingency planning, these security plans do not document detailed steps to recover application hardware, software, and telecommunications, nor do the plans identify alternative processing locations for the applications.

RECOMMENDATIONS

We recommend that the OCFO

22. Have responsible office directors provide training to all application owners on the importance of developing, maintaining, and testing contingency plans in accordance with EPA and Federal guidelines and ensure the plans clearly define necessary recovery steps for each application.
23. Have the Director, Office of Budget, revise the Budget Automation System's contingency plan to contain (a) complete contact information for key personnel, and (b) alternate processing and return to normal operations procedures.
24. Have the Director, OFS, revise the PeoplePlus' contingency plan so it clearly describes whether the PeoplePlus plan or the Critical Applications Disaster Recovery Plan takes precedence during a recovery process.
25. Have the Director, OFM, revise contingency plans for all of their applications not subscribing to the National Computer Center Disaster Recovery Services (e.g., Financial Data Warehouse), in accordance with relevant Federal and EPA criteria and best practices.

AGENCY COMMENTS AND OIG EVALUATION

The OCFO concurred with our recommendations and provided details on corrective measures that would address some of the recommendations.

Attachment 2: Compliance with Laws and Regulations

10. EPA Should Continue Efforts to Reconcile Intragovernmental Transactions

While EPA improved reconciliations of its intragovernmental transactions during fiscal 2005, the Agency was unable to reconcile a material difference of $149 million with one Federal agency—the Department of Health and Human Services. Without the proper confirmations from its trading partners, EPA has limited assurance that intragovernmental balances are accurate. EPA had experienced similar occurrences in the past that prohibited it from fully complying with the applicable requirements.

Intragovernmental transactions have been classified by the Government Accountability Office as a Government-wide material weakness due to the lack of standardization in recording and processing intragovernmental activities. To resolve the issue, OMB established standard business rules (Memorandum M-03-01, October 4, 2002) to be used in intragovernmental exchange activities. OMB Circular A-136, *Financial Reporting Requirements*, which was updated August 2005, requires Federal agencies to report intragovernmental assets, liabilities, revenue, and certain reporting entities with their trading partners. This information is to be presented in the financial statements as Required Supplementary Information and should agree with line items reported on the balance sheet.

The U.S. Treasury's *Federal Intragovernmental Transactions Accounting Policies Guide* was updated in July 2005 and provides Government-wide accounting policies for Federal agencies to account for and reconcile intragovernmental transactions. The Guide provides tools (procedures and examples) to facilitate quarterly reconciliation of intragovernmental activities. EPA has taken action to reconcile its intragovernmental activity on a quarterly basis. At year-end, the Agency had one material difference of $149 million in unreconciled activity with the Department of Health and Human Services.

RECOMMENDATION

We recommend that the OCFO

26. Require OFM to continue its efforts in reconciling the Agency's intragovernmental transactions to comply with Federal financial reporting requirements.

AGENCY COMMENTS AND OIG EVALUATION

The Agency agreed with the audit issue raised and believes that the unreconciled amount was a result of differing accounting methodologies between agencies. The Agency stated that will continue efforts to reconcile the Agency's intragovernmental transactions to comply with Federal financial reporting requirements.

1 We are reporting this noncompliance issue under FFMIA as it directly relates to FFMIA reporting requirements; however, the issue does not meet the OMB criteria for substantial noncompliance under FFMIA.

Attachment 3: Status of Prior Audit Report Recommendations

EPA's position is that "audit follow-up is an integral part of good management," and "corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations." The Chief Financial Officer is the Agency Audit Follow-Up Official and is responsible for ensuring that corrective actions are implemented. To resolve long-standing audit recommendations, the Deputy Chief Financial Officer formed an Audit Follow-Up Council in July 2000. The Council reviews the progress on audit findings, discusses approaches to resolving audit issues, and provides coordination and support across OCFO on audit-related matters. Council membership consists of the Deputy Chief Financial Officer, the OCFO Audit Follow-Up Coordinator, and all of the OCFO Office Directors.

The Agency has continued to make substantial progress in completing corrective actions from prior years. These issue areas from prior financial statement audits, with corrective actions in process, are listed in the following table.

Audit Issue Areas with Corrective Actions in Process
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.
EPA Needs to Strengthen Practices Regarding Security Screening for Non-Federal Personnel: An audit report issued during fiscal 2004 found that there are still some weaknesses regarding contractor access to IFMS. The Agency's 1999 Remediation Plan is still not completely implemented. The Agency expects to issue policy on security certifications for contractor and grantee personnel in October 2006.
EPA Continues Actions to Improve Cost Accounting: Since our last report, EPA has redefined its cost accounting outputs, improved the OCFO's Reporting and Business Intelligence Tool, continued to make progress in its data integration efforts, and has recently developed a report to show the full costs of its outputs. However, because the Agency did not produce reports that show the full costs of its outputs during fiscal 2005, the Agency was still not in full compliance with Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, although we do not consider the noncompliance to be substantial.
Further Improvement Needed for State Superfund Contract and Superfund Unbilled Oversight Accruals: EPA developed a review and certification process as a result of the fiscal 2005 Reportable Condition, but oversight of the accruals was still not effective. Please see Attachment 1 for additional information.
EPA Did Not Promptly Record Marketable Securities: The Agency began performing quarterly reconciliations of noncash assets in fiscal 2005 in response to our finding in fiscal 2004. However, we found an instance where marketable securities received from one company in settlement of debts for receivables at one region were not recorded promptly. We made recommendations to the Agency during this year's audit to improve its reconciliation procedures, but have not included it as a Reportable Condition in Attachment 1 because we found only one nonmaterial instance of a problem.
EPA Continues to Experience Difficulties in Reconciling Intragovernmental Transactions: EPA improved reconciliations of its intragovernmental transactions during fiscal 2005; however, the Agency was unable to reconcile a material difference with one Federal agency. Please see Attachment 2 for additional information.
Weaknesses in Change Control Procedures for Integrated Financial Management System: EPA has a Plan of Action and Milestones to correct these weaknesses. The Agency reports that a number of actions have been completed, and the remaining actions are targeted for completion by March 31, 2006.

Appendix I: Agency's Response to Draft Report

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

OFFICE OF THE
CHIEF FINANCIAL OFFICER

November 10, 2005

SUBJECT: Draft Audit Report: Response to Audit of EPA's Fiscal Years 2005 and 2004 Consolidated Financial Statements

FROM: Lyons Gray
Chief Financial Officer (2710A)

Lyons Gray

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

My staff and I thank you for the opportunity to respond to the Draft Audit Report of the Environmental Protection Agency's Fiscal Year 2005 and 2004 Financial Statements. The Office of the Chief Financial Officer's (OCFO) perspective on the audit's observations and recommendations is provided in the attached document.

We agree with the audit issues raised. EPA has effective internal controls with strong policies and procedures in place and I believe that corrective actions will strengthen compliance with existing policies and procedures. We are evaluating the best method to address each issue that will achieve a timely resolution of audit issues.

As a result of increased vigilance in FY 2005, our internal assessments uncovered some areas that required strengthening. We worked proactively to devise and implement long-term corrective actions for these issues. We believe the issues raised by the OIG during the FY 2005 audit validated our internal "self assessments" and corrective actions. We appreciate OIG acknowledgement of our efforts and progress in this audit report.

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

Attachment

Cc: Mike Ryan
Maryann Froehlich
Lorna M. McAllister
Dennis Nolan
OCFO Office Directors
OFM Staff Directors

Appendix I, Attachment I: OCFO's Response to the FY 2005 and FY 2004 Draft Audit Report

REPORTABLE CONDITIONS

1. *Payroll Internal Controls*

OIG found that EPA made payroll payments to separated employees. OIG recommends that OCFO work with EPA's Administration and Resources Management office to ensure proper processing of personnel actions, modify automated controls, and reinforce existing controls.

At the beginning of FY 2005, OCFO implemented a new time and attendance system. OCFO made significant strides to assure system transparency to the Agency and compliance with established payroll policies and procedures. In FY 2006, OCFO will continue to validate payroll system internal controls, enforce existing procedures, and take further corrective actions as necessary.

2. *Excess Salary Payments*

OIG found the OCFO's payroll system made excess salary payments to employees totaling $14,891 of a $54 million bi-weekly payroll, which equates to .04% of total payroll.

OCFO has automated internal controls in place for the majority of potential causes for salary overpayments and manual controls in place for many others. OCFO is initiating enhancements to broaden the scope of automated controls to replace existing manual controls. We will continue to evaluate the results as part of our bi-weekly payroll review process.

3. *Superfund State Contract (SSC) and Superfund Unbilled Oversight Accruals*

The OIG noted areas where increased oversight would improve the management of SSC and Superfund unbilled oversight accruals.

In the past year, OCFO made considerable progress towards assuring consistency with SSC and Superfund unbilled oversight accrual calculations. As OCFO continues its efforts to consolidate accounting operations, we will explore options for centralizing these accrual processes.

4. *General Ledger Account Adjustments for Receivables Transferred to Cincinnati Finance Center*

OIG Identified regional offices' accounts receivable and allowance for doubtful accounts that needed adjustment during an OCFO functional and consolidation process.

As part of the process to consolidate EPA's financial operations into four finance centers, the Agency successfully transferred five of the ten regions' accounts receivable functions to one finance center. An account analysis identified accounting point balances that required adjustments that are reflected in the financial statements. As the Agency progresses in transferring the accounts receivable functions from the remaining five regions, OCFO will continue to monitor appropriate general ledger accounts and assist the Financial Management Officers in resolving account balance issues.

5. *Quality Assurance (QA) Reviews*

The OIG recommends increased oversight of the QA program activity to ensure comprehensive reviews and adequate documentation.

In FY 2005, OCFO made significant progress with the QA program. OCFO updated and published the QA Guide on the EPA intranet. It reflects current policies, procedures, and approaches to evaluating accounting functions. In addition, OCFO conducted a specialized session on QA reviews and their relationship to the revised OMB Circular A-123 requirements. To continue the QA program's success, OCFO is conducting a training class in December 2005 for Agency finance personnel.

6. *Distribution of the Budget Clearing Accounts*

OIG identified interagency transactions that were inappropriately distributed. In this instance, EPA billed other agencies and two transactions were returned two days prior to the close of the fiscal year. EPA reissued the bills in October 2005 and the FY 2005 financial statements reflect the appropriate accounting adjustments.

7. *Documentation of Adjustments to the Integrated Financial Management System (IFMS) Entries*

The OIG noted instances of adjusting entries made without proper or adequate documentation.

OCFO's Policy Announcement 93-02, dated November 13, 1992, requires adequate source documentation to support all financial transactions. OCFO will insist that Financial Management Officers ensure that all adjusting transactions entered into the Agency's accounting system be adequately documented and easily accessible in accordance with the Policy Announcement.

8. *Correcting Rejected Transactions*

OIG observed instances of rejected data transfers between PeoplePlus (PPL) and IFMS that were not resolved in a timely manner.

OCFO took action to identify and correct the rejected data for 16 employees. The Office of Human Resources implemented a control that should prevent a reoccurrence.

9. *Contingency Plans for Financial Applications*

OIG noted instances where contingency plans for financial systems did not fully comply with Federal or EPA continuity guidelines.

OCFO remains firmly committed to securing its system and data in a cost effective manner and in compliance with Federal guidance, EPA policy, and best practices. In FY 2006, OCFO will revise current contingency plans to clearly state the critical operations, supporting resources, and alternate processing procedures for the financial systems identified by the OIG.

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA) NONCOMPLIANCE ISSUES

10. *Intragovernmental Transactions*

As OIG acknowledged, OCFO greatly improved reconciliations of its intragovernmental transactions during FY 2005. However, at year end, EPA was unable to reconcile a large difference with one Federal agency.

EPA believes this is a result of differing accounting methodologies between agencies. EPA will continue efforts to reconcile the Agency's intragovernmental transactions to comply with Federal financial reporting requirements.